SEC OVERREACH: EXAMINING THE NEED FOR REFORM

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WEDNESDAY, MARCH 20, 2024

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

SEC OVERREACH: EXAMINING THE NEED FOR REFORM

Wednesday, March 20, 2024

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:09 a.m., in room 2128, Rayburn House Office Building, Hon. Ann Wagner [chairwoman of the subcommittee] presiding.

Members present: Representatives Wagner, Sessions, Huizenga, Hill, Steil, Meuser, Garbarino, Lawler, Nunn, Houchin; Sherman, Scott, Vargas, Gottheimer, Gonzalez, Casten, and Nickel.

Ex officio present: Representative Waters.

Also present: Representative Kim.

Chairwoman WAGNER. The Subcommittee on Capital Markets will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Today's hearing is entitled, "SEC Overreach: Examining the Need for Reform."

I now recognize myself for 5 minutes to give an opening statement.

I want to thank you all for joining today's hearing, where we will address clear examples of regulatory overreach at the Securities and Exchange Commission (SEC). The SEC's aggressive and burdensome regulatory approach reveals the urgent need for sensible reforms at an agency responsible for protecting investors, maintaining fair, orderly, and efficient markets and facilitating capital formation.

This hearing is specifically about examining the need for reform—under either a Republican or a Democrat SEC Chair—but reform at the SEC. SEC Chair Gensler's frenetic partisan rulemaking agenda at the SEC has threatened the health of U.S. capital markets and highlights the need for targeted institutional reform.

Today's hearing will explore the negative consequences of rulemaking based on theoretical assumptions rather than real-world impacts, and the alarming absence of stakeholder input and meaningful cost-benefit analysis during the rulemaking process. None of these topics covered today should come as a surprise to anyone who has paid attention to the SEC under Chair Gensler.

Likewise, each of our proposed reforms is targeted and practical. They will improve the 90-year-old agency, not overhaul it. They will not remove investor protections or kneecap the regulatory proc-

ess or politicize an independent Federal agency, despite what any Democrats may claim.

The problems and solutions highlighted today are clear to any observer of the SEC, with countless examples proving that the SEC, under Chair Gensler, would rather pursue partisan policy objectives than adhere to its statutory mission.

Democrats might argue that Chair Gensler has acted in the interest of investors. However, investors and companies in both the public and the private markets know otherwise and have been raising the alarm through both public comments and the courts.

For example, if Chair Gensler were truly concerned with the interest of investors, wouldn't he provide more than 30 days for market participants to review and comment on new rules? Wouldn't he propose new rules that have been substantially changed before they are finalized or encourage the thoughtful cost-benefit analysis that clearly shows how the benefits outweigh the costs of a new rule.

Moreover, if Chair Gensler truly believes our security markets are, "the envy of the world," as he often claims, you would expect that he would propose new rules only when there is an ambiguous data-driven need for such new rules. You would also expect that he would provide a reasonable, staggered timeline for companies to implement and comply with his massive set of new regulatory requirements.

Instead, since taking office in 2021, Chair Gensler has flooded the marketplace with roughly 60 new proposals and more than 30 final rules. Many of these proposed and final rules include sweeping new changes that were advanced without the requisite statutory authority, without a comprehensive cost-benefit analysis, or without satisfying the requirements of the Administrative Procedure Act (APA).

The best example is the Climate Disclosure Rule which was finalized earlier this month. As members of this committee have made clear, the SEC is not an environmental regulator nor was it given clear authority to finalize climate-related regulations that will only burden American businesses with serious costs.

The full Committee on Financial Services will explore that rule in detail on April 10th. In the meantime, today we will hear why our proposed slate of common-sense reforms is necessary to prevent an activist agency from accomplishing political objectives, sometimes in violation of the law.

This should not be a partisan issue. Members of Congress from both sides of the aisle should be concerned any time an agency oversteps its authority and should welcome the sorely-needed reforms we will be examining today that improve the rulemaking process at the SEC.

I would like to thank our witnesses for their testimony, and I look forward to our discussion.

The Chair now recognizes the ranking member of the subcommittee, the gentleman from California, Mr. Sherman, for 4 minutes for an opening statement.

Mr. SHERMAN. I am going to use the first minute to talk about a housing issue and the effect of this new antitrust decision on first-time homebuyers. If you buy a $500,000 house, you are not

just paying for the plumbers and the carpenters; you are also paying for the real estate agents, and the bank is financing that. So if you are going to buy a $500,000 home, you need $50,000 for a 10-percent down payment.

Under the new system, the buyer is supposed to pay their own agent or adviser. That would mean that they would have to come out of pocket not just that $50,000 down payment, but another $15,000 for their agent. We should pass a law that makes it plain that when you finance a home, the loan should include, as it does now, the amount being charged by the agents. So, that same $500,000 home would get a $450,000 mortgage. If we don't do that, then a couple trying to build up their down payment, instead of having to do that for 10 years will end up spending 13 years before they can afford to buy a home.

As to the matter before us, the rule in Washington is clear. When the facts are with you, argue the facts. When the public policy is with you, argue the public policy. And when you have bad facts and you are wrong on the public policy, scream about the procedure. And that is what the detractors of the SEC are doing.

The fact is that we do need guidance to be published from the SEC. When the SEC provides that guidance in the crypto accounting area, then we are told, oh my God, we don't need guidance. We just need a patina of regulation but not any real regulation for the crypto industry, so they can give the illusion that they are regulated.

I should point out that the SEC is finally doing what we told them to do, by law, in the Dodd-Frank Act in 2010. We are not watching a Nascar race. We are watching a turtle race in which now, in 2024, the SEC is doing what we told them to do back when I had hair. Okay, I still didn't have hair then.

I want to point out that this recent near government shutdown has delayed initial public offerings (IPOs), because anybody trying to raise money in the Capitol knew that the SEC would have to shut its doors or might not shut its doors or might shut its doors, and that has made it more difficult for the United States to compete for capital worldwide by showing that we had a workable government and financial system.

As to the length of time for commenting, the average that the SEC is giving is 67 days. And the way to calculate that is from the day the SEC publishes the proposed rule on their website, not waiting many days later until it finally gets published in the Federal Register.

Why is that more relevant? Because if you talk to investors, or you talk to broker-dealers, they have all heard of the SEC, and if they want to know what the SEC is doing, they are going to go to SEC.gov. None of them have thought of the Federal Register.

I was just at the New York Stock Exchange. A dozen people mentioned the SEC. Not a single one of them mentioned the Federal Register.

We need climate disclosures because they are material to a material percentage of the investors investing in American markets. And this idea that we are going to deprive investors of the information they want because we don't want them to have it is a bad approach. And thank God the SEC has gone in the other direction.

I yield back.

Chairwoman WAGNER. The Chair now recognizes the ranking member of the full Committee on Financial Services, the gentlewoman from California, Ms. Waters, for 1 minute.

Ms. WATERS. Thank you very much.

The SEC has played a critical role over the past 90 years in protecting investors from fraud and abuse and ensuring U.S. corporations provide adequate information about themselves so working families can make sound decisions with their money.

While the agency has done a solid job under the Biden Administration, I believe there is still much more work to be done. For example, we need transparency in the unregulated private securities markets, and we need rules to stop corporate executives from engaging in any work stock buybacks. And we need more comprehensive climate risk disclosures that apply to all issuers.

The SEC also needs to be fully funded so that it remains an effective and relevant regulator for the next 90 years. So, I look forward to this discussion today. And I yield back the balance of my time.

Chairwoman WAGNER. Today, we welcome the testimony of: David Burton, senior fellow in economic policy at the Thomas A. Roe Institute for Economic Policy Studies at the Heritage Foundation; John Gulliver, executive director of the Committee on Capital Markets Regulation; Jennifer Schulp, director of financial regulation studies at the Center for Monetary and Financial Alternatives at the Cato Institute; and Alexandra Thornton, senior director of financial regulation at the Center for American Progress.

We thank each of you for taking the time to be here. Each of you will be recognized for 5 minutes to give an oral presentation of your testimony. And, without objection, each of your written statements will be made a part of the record.

Mr. Burton, you are now recognized for 5 minutes for your oral remarks.

STATEMENT OF DAVID R. BURTON, SENIOR FELLOW IN ECONOMIC POLICY, HERITAGE FOUNDATION

Mr. BURTON. Thank you. My name is David Burton, and I am the senior fellow in economic policy at the Heritage Foundation. I would like to express my thanks to Chairwoman Wagner, Ranking Member Sherman, and the members of the subcommittee for the opportunity to be here this morning.

As the most important regulator of U.S. capital markets, the Securities and Exchange Commission has a vital mission. We need an effective cop on the beat to prevent fraud, to ensure adequate disclosure, and to promote efficient markets if we are to have a strong capital market, a vibrant economy, and to protect and secure the savings of the American people.

Unfortunately, despite its glowing self-image, the Commission does an increasingly bad job of discharging its core functions. There are at least five reasons for this. First, Commission resources have flowed into unnecessary management support and ancillary functions while core functions have been neglected. The SEC is managed exceedingly poorly and has been for quite some time. Its organizational structure is unwieldy and inconsistent with sound man-

agement practices. It is among the most management-heavy and bureaucratic agencies in government. Its information technology function is among the most expensive and least effective in government. Oversight of its contracting process is poor.

Second, it provides inadequate oversight of so-called self-regulatory organizations (SROs). And in the aggregate, these non-governmental organizations (NGOs) to whom regulatory authority has been delegated have personnel levels and budgets that are comparable to the SEC itself.

Third, the Commission does an inadequate job of providing the information necessary for policymakers, whether Commissioners or Members of Congress, to make informed judgments about the policy choices that they face.

Fourth, the Commission has failed to address current regulatory issues, opting instead to pursue regulation by enforcement or to largely ignore serious problems.

Fifth, and last, the Commission is now pursuing political and ideological objectives that are unrelated to its core mission.

In my written statement, I address all of these issues in detail.

Under Chairman Gensler, massive amounts of Commission staff time and resources have been diverted to ideological projects that are unrelated to the Commission's statutory charge. Entirely independent of the merits of his ideological objectives, this pursuit is doing real damage, because the Commission is increasingly ignoring its real job. Instead, it is focusing on climate regulation, diversity, equity, inclusion, board diversity, and various social justice objectives under the rubric of human capital management.

The Commission is a securities regulator. Its mission is to protect investors and promote efficiency, competition, and capital formation. It is not meant to right every conceivable social wrong nor can it do so. It is not an environmental regulator. It is not the Equal Employment Opportunity Commission (EEOC) or the U.S. Commission on Civil Rights. It is not the Department of Labor or the National Labor Relations Board (NLRB). It should discharge the mission that Congress has given it.

I would like to briefly run through a number of the pieces of legislation that the committee is considering. I will have to do this quickly, but the legislation that would roll the Public Company Accounting Oversight Board (PCAOB) back into the SEC is welcome. Creating the PCAOB was a mistake, and putting it back in the government will restore due process, transparency, and rulemaking protections normally associated with government.

The SEC Regulatory Accountability Act is a very well-drafted piece of legislation. It would codify in the Securities and Exchange Commission the requirement to conduct rigorous cost-benefit analysis in the rulemaking process and provide for a robust and detailed retrospective review process. It would also apply these requirements for the first time to the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) by making the SEC determine that they complied with these requirements before the SEC approves those rulemakings.

The legislation that would require a Government Accountability Office (GAO) study of the information technology (IT) programs at

the SEC are welcome. As I go into significant detail in my written statement, the SEC's IT department is among the most expensive in government and among the least effective.

I am very sympathetic to the goals and objectives of the legislation that would require a GAO review of the SEC cost-benefit analysis and up to 10 rulemakings, and I go into some more detail about that in my written statement.

I think the legislation requiring at least a 60-day comment period for rulemakings is entirely warranted, particularly given the size, scope, and complexity of the rules that the SEC is putting out these days.

With that, my time has expired, and I look forward to answering your questions.

[The prepared statement of Mr. Burton can be found on page 42 of the appendix.]

Chairwoman WAGNER. Thank you, Mr. Burton.

Mr. Gulliver, you are now recognized for 5 minutes to give your oral presentation.

STATEMENT OF JOHN A. GULLIVER, EXECUTIVE DIRECTOR, COMMITTEE ON CAPITAL MARKETS REGULATION

Mr. GULLIVER. Thank you, Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee for inviting me to testify before you today on the topic of, "SEC Overreach: Examining the Need for Reform." My testimony today is my own and does not necessarily reflect the views of the Committee on Capital Markets Regulation or its members.

The United States benefits from the world's most-efficient capital markets. This means that companies can raise the funding needed to grow and investors can earn a return on their savings at a low cost. The U.S. capital markets are, therefore, critical for economic growth and prosperity.

The SEC is tasked with the vital role of regulating approximately 3,600 public companies as well as the broker-dealers, investment advisers, and other market participants that presently provide 76 million U.S. households with the opportunity to invest in our markets.

Over the past 3 years, under Chair Gensler's leadership, the SEC has embarked on an unprecedented rulemaking agenda that will have a major impact on the cost of being a public company and investing in our markets.

The SEC has done so without a new statutory mandate or a market crisis presenting the need for holistic reform. The SEC has also not conducted a comprehensive analysis of how its rulemakings will collectively impact public companies and investors. Therefore, now is precisely the time to consider whether reforms to the SEC's regulatory process are needed.

As with all Federal agencies, the SEC is required to provide the public with an opportunity to comment on its proposed rules. The SEC is also required to conduct an economic analysis as part of each rulemaking, and SEC rules are subject to review and reversal by the courts if they fail to comply with these requirements.

Over the past 3 years, there have been significant deficiencies with the SEC's regulatory process. Short public comment periods

for SEC rulemakings have failed to reflect a proposal's significance and complexity. According to an estimate by the Securities Industry and Financial Markets Association (SIFMA), the average period of time for comment for recent SEC proposals has been just 47 days. This has made it difficult, if not impossible, for the public to fully analyze and respond to the SEC's proposals.

The SEC has also, on several recent occasions, issued rules on overlapping issues, such as the securities lending and short-selling disclosure rules, but failed to consider their aggregate impact or the interaction between those rules. This has resulted in conflicting regulations, and the SEC's securities lending and short-selling rules are now being challenged in the Fifth Circuit on this basis.

Economic analyses by the SEC have also had major shortcomings. The SEC's share buyback rule was recently overturned by the Fifth Circuit due to flaws with its economic analysis.

And the SEC's private funds rule, which is also being challenged in court, also has fundamental issues with its economic analysis. For example, the SEC asserted that there is a lack of competition in the market for private equity fund, venture capital fund, and hedge fund advisers.

However, the SEC ignored the fundamental metrics that both government authorities and academic experts use to measure whether a market is competitive. And the evidence on private fund fees, performance, and industry concentration demonstrates that the private funds market is highly competitive, thus undercutting the SEC's economic analysis and Chair Gensler's basis for the rulemaking.

Due to these various shortcomings, I support legislative reforms to clarify and enhance the SEC's regulatory process. As part of its economic analyses, the SEC should be required to, one, clearly identify and substantiate that a market failure exists and that a rule will address that failure; two, make a reasonable determination that the benefits of a rule would outweigh its costs; and, three, consider the effects of other related rules, including proposals. These recommendations are consistent with the SEC Regulatory Accountability Act.

The SEC should also be required to periodically review its past rulemakings to identify rules that have been become obsolete or ineffective, as is required now in the European Union.

Congress should also establish a minimum comment period of 60 days for SEC rulemakings, and 180 days for complex rules. This would be consistent with existing Federal agency guidelines.

Thank you for the invitation to testify before the subcommittee today.

[The prepared statement of Mr. Gulliver can be found on page 63 of the appendix.]

Chairwoman WAGNER. Thank you, Mr. Gulliver.

Ms. Schulp, you are recognized for 5 minutes to give your oral remarks.

STATEMENT OF JENNIFER J. SCHULP, DIRECTOR, FINANCIAL REGULATION STUDIES, CENTER FOR MONETARY AND FINANCIAL ALTERNATIVES, CATO INSTITUTE

Ms. SCHULP. Chairwoman Wagner, Ranking Member Sherman, and distinguished members of the Subcommittee on Capital Markets, my name is Jennifer Schulp, and I am the director of financial regulation studies at the Cato Institute Center for Monetary and Financial Alternatives. Thank you for the opportunity to take part in today's hearing.

Regulatory decision-making by the Securities and Exchange Commission directly impacts our securities markets. While the stock market and the economy are not one and the same, the ability of individuals and entities to raise capital to grow their businesses and the ability to invest in businesses is the backbone of American economic growth.

The SEC's mission cannot be and is not intended to be carried out without accountability to elected officials and input by the public. The SEC, however, falls short of this ideal.

The Commission would benefit from reforms aimed at increasing the agency's accountability and transparency, ensuring adequate input and analysis for rulemaking, and holding the agency to high standards in the exercise of its functions.

First, congressional oversight is critical to ensuring the proper functioning of the Federal Government. Regular testimony by the SEC Chairman and Commissioners can increase the agency's accountability and transparency and depoliticize the fact of congressional oversight.

Other reforms to the SEC's enforcement authority can increase accountability. The Commission's gag rule on settling defendants silences critics who can help Congress and the public hold the agency accountable. And the SEC's use of administrative law judges similarly denies defendants and the public of the accountability provided by independent judicial courts.

Second, the Commission has a mixed record, at best, at complying with the Administrative Procedure Act (APA), which provides for public participation in the rulemaking process and sets forth the basic standards for rulemaking.

The Commission has often inappropriately relied on agency guidance and enforcement actions to create new regulation. These tools produce less-certain and less-clear rules and can result in unfair treatment of market participants, undermining public trust in the agency.

Moreover, pursuing these pathways decreases regulation quality by preventing public input, which is at the heart of the APA's design for rulemaking. Under the APA, an agency must provide a meaningful opportunity to comment on proposed rules.

The current SEC has advanced an aggressive rulemaking agenda and has provided less opportunity for public comment. These rule proposals have been complex and interconnected, increasing the burdens to analyze and meaningfully respond. Congress should consider setting a baseline for SEC comment periods, ensuring appropriate time for public input. The Commission should also repropose rules for public comment where the rule is substantially revised from the proposal.

The SEC is also required by the APA to weigh and, where possible, quantify the costs and benefits of a proposed regulation. But the SEC's economic analyses often fail to account for costs and rely on speculative benefits.

This is particularly apparent where the SEC's interconnected rule proposals do not analyze the impact of each proposal on the others. A clear, legislative cost-benefit analysis requirement may assist in shoring up existing obligations.

Third, the Commission continues to suffer from embarrassing cybersecurity and information technology incidents. The information that the Commission collects should be right-sized by, for example, prohibiting investor personally identifiable information in the Consolidated Audit Trail (CAT). This not only avoids the question of whether the SEC can safeguard the data, but also avoids serious constitutional concerns with such surveillance.

The agency must also identify and promptly remedy cybersecurity and information technology weaknesses. The SEC recognizes for its regulated entities that managing cyber and information risks is critical to the operation of the financial markets. Yet, within the past 2 years, the SEC has been hacked on X, not received public comments due to a glitch with an internet comment form, and allowed enforcement staff to access administrative law judge documents. Such issues have market impacts and erode confidence in the agency.

To sum up, the Commission would benefit from reforms to improve its accountability, responsiveness, and competence, regardless of the Commission's policy agenda.

Thank you, and I welcome any questions you may have.

[The prepared statement of Ms. Schulp can be found on page 84 of the appendix.]

Chairwoman WAGNER. We thank you, Ms. Schulp.

Ms. Thornton, you are recognized for 5 minutes to give your oral remarks.

STATEMENT OF ALEXANDRA THORNTON, SENIOR DIRECTOR, FINANCIAL REGULATION, CENTER FOR AMERICAN PROGRESS

Ms. THORNTON. Thank you, Chairwoman Wagner, Ranking Member Sherman, and esteemed members of the subcommittee. Thank you for the opportunity to appear today.

In the interest of time, I will focus my oral remarks on the Commission's rulemaking process and the Private Fund Advisers Rule.

The Administrative Procedure Act (APA) does not require an agency to make changes in response to every comment. Court decisions are clear that the point of the APA process is for the agency to make a reasonable effort to solicit relevant information so that it can examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made.

This is not what is happening now. Instead, opponents of SEC rulemakings are misusing reasonable administrative process protections and turning them into years-long gauntlets for agency actions. And a handful of relatively recent court decisions have made this process even more burdensome on the agency and thrust important rules into jeopardy.

These outside pressures have added unreasonable expectations for the administrative process, impeding the SEC's ability to do its job of protecting investors and promoting fair, orderly, and efficient markets.

In response to attacks, the Commission appears to be bending over backwards to allow for lengthy periods of comment by routinely considering comments received outside the comment window even though that is not legally required, and reopening formal comment periods. And it now appears to seek to address nearly every point raised by commenters, regardless of the relevance or when received. Meanwhile, the Commission's economic analyses are longer and much more complex.

The result of all of this analysis is paralysis. As the agency's agenda shows, many rules sought by business and investors respectively have yet to be proposed, much less finalized. Larger companies, financial firms, and other market participants often overwhelm the agency with letters, which far outstrips the agency's ability to sift through the morass. The agency simply does not have enough staff to engage in this strained analysis for thousands of comments on every single rulemaking.

One legislative proposal being considered today calls for congressional disapproval of the Private Fund Advisers Rule finalized last September——

Chairwoman WAGNER. I would ask the witness to suspend for just a moment. There seems to be a ruckus here in our—if you would like to join us, we would welcome you, if you could just sit quickly and quietly. You are most welcome.

My apologies, Ms. Thornton. Please do continue.

Ms. THORNTON. Certainly. Now?

Chairwoman WAGNER. Please do continue, ma'am.

Ms. THORNTON. Private funds have grown in size, complexity, and number in the past decade since the Dodd-Frank Act required private fund advisers to begin registering with the SEC.

More than 5,000 SEC-registered investment advisers, roughly 35 percent of all SEC-registered advisers, manage about $18 trillion in private fund assets.

The SEC's Division of Examinations has found substantial concerns with deficiencies of private fund advisers. In response, the Private Fund Advisers Rule addresses common risks and harms in an adviser's relationship with private funds and their investors: lack of transparency; conflicts of interest; and lack of effective governance mechanisms for client disclosure consent and oversight.

The disclosures to address these are all squarely within the SEC's authority to require from private fund advisers. This essential rule takes on heightened importance, given the rapid growth of private markets generally.

Today, teachers, firefighters, and millions of other workers with public and private retirement plans are materially exposed to the private markets, and private fund advisers have significant control over these investments.

Over the past few decades, Congress and the SEC have dramatically expanded exemptions from application of the Federal securities laws, including ongoing public reporting requirements. This has led to the explosive growth of private markets, where more

capital is now raised annually than in the public markets. And while companies with a large number of holders of record have long been required to begin public disclosures, a loophole has allowed companies to effectively avoid the law's application even if they have tens of thousands of beneficial owners or shareholders.

Allowing extremely large companies that have thousands of employees and sell to millions of Americans to avoid basic disclosure rules invites waste, fraud, and abuses not unlike those that predated the adoption of the Federal securities laws. Exemptions are dismantling the securities laws that have served the U.S. capital markets for so long and made them the most-liquid and most-trusted markets in the world.

During debate over securities legislation in the 1930s, Congress considered making the SEC a merit regulator with authority to prevent securities offerings that did not meet standards of quality. It rejected that idea with the understanding that companies seeking capital from the public would be required to make any disclosures that the SEC found to be, "in the public interest and for the protection of investors." This language is repeatedly mentioned in the statutes and legislative history of the securities laws.

But the wholesale exemption of securities offerings from the public disclosure framework has undermined Congress' intent. The solution is either to give the SEC a stronger hand in making regulations aimed at protecting all investors from investments they cannot possibly understand well enough to make a sound investment decision, no matter how sophisticated they are, or, alternatively, to shrink the exemptions, and close the loophole, so that larger companies comply with the public disclosure framework, and prevent the remaining private companies from raising capital from retail investors, directly or indirectly, without providing the same types of disclosures that public companies make.

Thank you again for inviting me to testify today. I look forward to answering your questions.

[The prepared statement of Ms. Thornton can be found on page 98 of the appendix.]

Chairwoman WAGNER. Thank you, Ms. Thornton.

Now, we will turn to Member questions, and I recognize myself for 5 minutes.

Mr. Gulliver, I am deeply concerned with the quality of analysis that SEC staff includes with many of its proposed and final rules.

In the equity market structure proposals, for example, SEC staff apparently cut and pasted the same economic analysis and applied it to every rule.

My bill, the SEC Regulatory Accountability Act, requires the SEC to consider specified factors before issuing regulations. Could you explain how my bill would improve the quality of the SEC's analysis, sir?

Mr. GULLIVER. I think the most significant improvement is it would require the SEC to identify an actual problem. There is no problem in the U.S. equity market structure. The SEC's economic analysis ignore the fact that the U.S. equity market structure provides the lowest cost in the world. The cost to trade in the U.S. is lower than it is in Europe, the UK, Japan, Hong Kong, or any

other developed market. So, I think that would be a major improvement.

Chairwoman WAGNER. And could you explain how higher-quality analyses would promote better policymaking outcomes and prevent overreach?

Mr. GULLIVER. I think, most importantly, it is a fundamental point of policy that the benefits of a rule should exceed its cost. So, requiring that explicitly through legislation would serve an important policy purpose.

Chairwoman WAGNER. And we certainly need more specific economic analysis than just literally cutting and pasting the same analysis over and over again. It was stunning.

Mr. Gulliver, what would you say to Democrats who believe there is nothing wrong with the quality of the SEC's economic analyses?

Mr. GULLIVER. I would say that issues with the SEC's economic analyses have been raised by former SEC Chief Economists from both Democratic and Republican Presidents.

Chairwoman WAGNER. Yes.

Ms. Schulp, as Chair of the subcommittee, I am committed to making sure unelected officials, like SEC Chair Gensler, remain accountable to the American people. And as part of those efforts, throughout this Congress I have brought each of the SEC Division Directors in to testify before this subcommittee. The Full Committee has also brought Chair Gensler in to testify on several occasions.

Ms. Schulp, can you explain why it is important that regulators testify before Congress on a regular and more-frequent basis?

Ms. SCHULP. First, this type of exchange of information between Members of Congress and regulators is an important one, and it supplements letters that go back and forth that might not be answered.

Chairwoman WAGNER. All the time.

Ms. SCHULP. ——or may not be answered in an appropriate manner. But it is also important to have a live back-and-forth between a Member of Congress and the entity that it is regulating in the public sphere.

It is very important to make sure that this is standardized as well and happens regularly, so that it is not simply that oversight happens when there is divided government.

Chairwoman WAGNER. I wonder what impact might it have if the full Commission, not just the Chair, were to regularly testify before Congress? Would it remind the Commission of its accountability to Congress and the American public?

Ms. SCHULP. It should remind the Commission of such. And it is also important, because the Commission is a five-member body; it is not simply the Chair. And that body was designed to be bipartisan.

Hearing from minority viewpoints as well as viewpoints other than the Commissioner is important for Members of Congress as well as the public.

Chairwoman WAGNER. Mr. Burton, last year the SEC adopted an onerous cybersecurity risk management rule which, as Commissioner Peirce explained, "ignores both the limits to the SEC disclosure authority and the best interests of investors." Just a few

months later, the SEC's official X account, formerly known as Twitter, was hacked.

Mr. Burton, can you elaborate on the quality of information technology management at the SEC?

Mr. BURTON. Yes. I think you have identified a very important problem with the SEC, and it falls under a couple of categories. One is data security. The SEC documents, if they are hacked, can move markets and people can trade on information that is not yet public and make a great deal of money.

But there are other problems. For example, the public disclosure system under the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system sort of involves time travel. You feel like you are going back to the 1990s, because it is so bad. And most people don't use EDGAR to get the information. They use private systems that rely on data——

Chairwoman WAGNER. Mr. Burton, because my time is about to expire, what signal does it send when the SEC's own social media account is hacked just a few months after it imposes onerous cybersecurity requirements on the companies it regulates?

Mr. BURTON. It shows that the SEC is not doing its job. The SEC's IT department is 5 times more expensive than the average, and they have worse results.

Chairwoman WAGNER. I thank you. And my time has expired.

I now recognize the ranking member of the subcommittee, the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. I would say, what signal does it send when Congress comes within days of defunding the SEC or suspending its funding again and again?

Perhaps the worst slogan I have heard in politics is, "defund the police." The SEC is the police department of our $100-trillion capital markets, and several different times we have come within days of not having the cops on the beat.

I join with the Chair in saying that we should have the entire Commission here, and I look forward to those hearings. I think the ratings on C–SPAN 3 will go through the roof to the moon.

There is this argument that we are moving too fast. I think we are just catching up with mandates that we imposed in 2010. And with climate disclosure, we have been wanting that since Al Gore was living in the Naval Observatory. Finally, we have it. And I think the SEC did a good job on a very difficult thing.

This does not mean that the SEC is perfect. First, we haven't forced disclosures from giant nonpublic companies that play such a critical role in our country. But, looking at what the SEC has jurisdiction of, the definition of, "accredited investor," relates to whether you have a $200,000 income when it should relate to the knowledge of your truly independent investors, and the percentage of your net worth that you are investing in the company.

The SEC's proposals on swing pricing and the related liquidity proposals, I think will do more harm than good, but particularly the swing pricing proposals.

We do need regulations. The crypto industry has come to us many times saying, please, tell us what the rules are. Of course, whenever rules are meaningful, they rebel against them.

And it is said that our capital markets are great and they are the envy of the world, but that doesn't mean we shouldn't be looking more to cut costs.

One of the bills that the witness pointed out deals with the PCAOB. We need a PCAOB. I was here when we had WorldCom and Enron. And I don't think the PCAOB is broken, but I would be supportive of that bill bringing it inside the SEC if we also did it with the Financial Accounting Standards Board (FASB), which is broken in one critical respect, which is that, flying in the face of any reasonable accounting theory, they have mandated writing off research and development (R&D) expenses when they should be capitalized. And if they were, our companies, particularly the nontech companies, would be doing far more R&D. So if the PCAOB structure is bad, it is also the same structure basically as the FASB. And if we want to bring them in-house, let's bring in-house the one that is broken or is broken as to one major aspect.

As to insufficient comment periods, I would support legislation saying 60 days for any complex rule, but those 60 days have to be measured from when the SEC puts it on their web page.

Ms. Thornton, there are those who say that if you want to make an investment based on something other than earnings per share, say, on the basis of whether the company is doing a good job in reducing its climate footprint, that you should be deprived of the right to manage your own money, not by appointing a conservator, which we do for those who are criminally insane, but rather, just deprive you of the information that would allow you to make a decision.

Does it make sense in a capitalist society to tell people with capital that they can't make a decision based on climate?

Ms. THORNTON. Not at all. In fact, capitalism is about information. Information is what makes capitalism work. And there are many kinds of information that have an impact on the value of a company and would impact an investor's decision about whether to invest—things like climate risk, because that can actually determine whether a company is resilient in the long run, whether it is prepared for changes in the law around emissions, for example, but also in the near term, whether it is ready for disasters that are obviously coming. We have more and more billion dollar——

Mr. SHERMAN. If I can interrupt, I think investors are interested in how the company affects the environment, but also how the environment is going to affect the profitability of the company. That information needs to be disclosed, and we also need more information about workforce, particularly training and turnover.

I yield back.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the gentleman from Texas, Mr. Sessions, for 5 minutes.

Mr. SESSIONS. Madam Chairwoman, thank you very much for holding this hearing.

Mr. Gulliver, thank you for being here. I am going to use my few minutes with you. I am delighted to see that you are here today.

You have written rather extensively about what happened back in 2022, when the S&P companies spent over $900 billion to buy back their own stock, followed up in May of 2023 by the Securities

and Exchange Commission adopting a rule that would have required public companies to disclose information about stock repurchases, including certain repurchased data within one business day, and the rationale for doing that. In other words, the Federal Government would require you to tell us why you did what you did, a private business.

This was later vacated by the Fifth Circuit on December 19, 2023. The essence of the argument was that the SEC did not even follow their own rules, did not include a proper cost-benefit analysis of what this regulatory overview would mean to the industry.

But what bothers me is it is based upon a philosophy. In my opinion, it is a parasite designed to kill the host by the SEC. It is actually the SEC trying to work against that which they are expected to nurture and grow as part of not just American exceptionalism but perhaps, more importantly, capitalism.

Can you talk about this action by the SEC to the entire marketplace?

Mr. GULLIVER. I think the SEC's Share Repurchase Disclosure Rule is an example of a particularly flawed cost-benefit analysis and the importance of doing a high-quality analysis.

The SEC asserted that there was a problem where executives were buying back shares on a particularly advantageous basis for themselves, but in fact, they didn't provide any evidence to support that claim. And the court found that the SEC is obligated to do so in all of their economic analyses. So, one positive takeaway from this is that in future economic analyses, if the SEC claims there is a market failure, they have to substantiate it.

And the second issue was the SEC said there was no data to really do an in-depth analysis of whether or not this is a problem, but commenters provided the SEC with that data. And the court said, we are invalidating the rule for that on that basis.

Mr. SESSIONS. So, you have come to this committee, and we hear about the cops on the beat, and how important it is for the SEC to do this. Yet, they are the party that wants to defund the police. They are the ones that don't want police who follow the law and rules. A police officer on the beat can't just make up his own reason for doing something, can they? No, they cannot, but the SEC believes they can.

Time after time, we have seen this with 1071, or any of a number of examples where the SEC does what they want to do. I believe, and I think what has been proven by this committee, is that they are attempting to put into place and to harm the economic growth of the United States of America, the marketplace, and the things that would build value not only for all Americans, but the stock market in America specifically.

What other examples do you have of this overreach and overregulation?

Mr. GULLIVER. I think one of the most concerning examples is the SEC reaching into private markets. Our private markets have been successful for a number of reasons, but what we have been seeing in those markets is a reduction in the fees that the large private funds charge, increasing performance, very strong performance, and small companies getting a lot of funding in these private markets.

The SEC is shifting in a direction of bringing more public regulations into these private markets. And I think that would be a big problem, because a big reason that companies are staying private longer is to avoid the burdens of being a public company.

Mr. SESSIONS. And that harms new entrants, doesn't it?

Mr. GULLIVER. Yes.

Mr. SESSIONS. Many times, businesses that are minority- or women-owned are trying to gain entrance into the marketplace, and they are making it far more difficult for them not only to enter the marketplace, but to be successful.

Would you call them activists?

Mr. GULLIVER. I think it has been a very aggressive SEC, unprecedented.

Mr. SESSIONS. It is against the free enterprise system. That is what this hearing is about today.

And I want to thank each of you for taking the time to be here today.

Madam Chairwoman, I yield back my time.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the ranking member of the full Committee on Financial Services, the gentlewoman from California, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much.

I am going to direct this question to Ms. Thornton. When most Americans think about our capital markets, they think of the New York Stork Exchange, and stocks sold by large companies like Apple, Ford, or GE. These are the public markets where new companies get to ring the bell when they go public and where U.S. capitalism flourishes.

However, many would be surprised to learn that the private markets now dwarf the public markets for where securities like these are normally offered and sold. Today, companies that have billions in revenue, tens of thousands of employees, thousands of shareholders, and engage in practices that impact the communities they operate in, are under no obligation to share information that their investors, consumers, or stakeholders may find important.

Could you discuss what gets lost when large companies that access our capital markets stay opaque and unaccountable? Does Congress need to set new rules for these types of large companies that have significant impacts on our society, or do you think the SEC has sufficient authority to promulgate rules in this space?

Ms. THORNTON. Thank you, Ranking Member Waters.

I think that there is a lot that the SEC can do here. There may be some things that Congress might need to do, but I think there is a lot that the SEC can do, because it created many of the exemptions that are allowing so many in the private markets to access capital, to grow in the private markets without limit and not having to go to the public markets.

There is a lot they can do also with respect to holder of record. I am not 100 percent sure that they can do that on their own. There is some debate about it. But holder of record does need to be defined as beneficial owners, and that is shareholders, not as holders of record, so that institutional investors who actually hold shares for thousands of clients are counted as one holder of record.

If you could change that rule, you would have a lot of these large companies automatically having to register, become public companies, and do the public reporting that is so necessary for huge companies that employ so many people and that sell products and services to millions and millions of Americans.

Ms. WATERS. Thank you.

As I am listening to some of our witnesses here today, they oppose regulation, too much regulation.

Do you think that they would oppose knowing and having information that you just described about beneficial ownership? What do you think?

Ms. THORNTON. I think all shareholders want information. Even the most sophisticated, intelligent investor cannot make good decisions without information. And the power dynamic in the private markets is unfair and unequal. Information that is given to one investor or group of investors does not have to be given to other investors because there is no cop on the beat, as you say.

And to address that, I think is one of the most important things and a critical thing that the SEC needs to do immediately, today, with the growth of the private markets, to protect investors.

Ms. WATERS. For the record, the SEC is our cop on the beat, protecting investors. This criticism that you have heard here today about them impeding economic growth, don't you think that perhaps that is a little misstatement about the SEC, for the record?

Ms. THORNTON. Yes. I think that without information, you can have inefficiencies. You can have fraud. That is a huge waste of resources and capital. Capital can't flow to the highest and best use if there isn't information for investors. So, yes.

Ms. WATERS. Do you believe that our investors today need to rely and depend on the SEC? And rather than stripping the SEC of its ability to regulate, they want to make sure that they are doing the job to protect their investments. What do you think?

Ms. THORNTON. I think that without rules, it is possible for people who would do that to take advantage of others not having the information. And that is what the SEC is there to prevent, and to ensure that everybody has access to information and that companies disclose important information, basic information, financials, basic information about operations and so forth. This is basic information that all investors need, and without the SEC, you wouldn't have disclosure of that.

Ms. WATERS. Thank you. I am so pleased you are here today.

I yield back.

Chairwoman WAGNER. The gentlewoman yields back.

The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, who is also the Chair of our Subcommittee on Oversight and Investigations, for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman. And I don't know about the rest of my colleagues, but I am opposed to too much regulation only when it defies common sense. And that, frankly, is what we are seeing here today in some of the defense of the indefensible.

Materiality is the watch word. And the most recent disclosure rule that the SEC has issued is not material. Let's be clear, public companies must—must—report any issue or circumstance that cur-

rently or in the future will materially affect their business operation and, therefore, affect investors.

And what the courts are saying is that the Securities and Exchange Commission is outside not only its traditional but its legal bounds when it comes to that materiality question with this most recent disclosure requirement.

Ms. Schulp, it's good to see you again.

Mr. Gulliver, I think you are now my new favorite Harvard professor after reading your testimony.

Mr. Burton, I want to focus in a little bit, though, on an issue that I have been working on about the PCAOB. The PCAOB, the Public Company Accounting Oversight Board, was founded in 2002 as an independent expert, a regulatory agency to oversee audits of public companies. In fact, the word, "independent," appears in statute 10 times.

It is safe to say that when Congress created the Board, they intended it to operate independently and without regard to political considerations, notwithstanding the SEC's oversight authorities, including approval of the Board's rules, standards, and budget. Those were all created by Congress as safeguards to ensure the Board's nonpartisan mission was maintained.

But in testimony before this subcommittee, PCAOB Chair Williams indicated that she was independent in her opinion and that her Board acts independently from the Commission. And I actually have a transcript, and I wanted to go back over and review that, which absolutely defends and says unequivocally yes, they are independent.

However, one of Chair Gensler's first acts in June of 2021, when he took over the SEC, was to actually remove that independent PCAOB Chair and subsequently remove and replace all of the remaining Board members of that independent Board.

In fact, Chair Gensler admitted in testimony here that the PCAOB was, in fact, not independent. So clearly, there is a disconnect.

Mr. Burton, by ousting former Chair Duhnke, and removing the full Board and inserting his handpicked replacements onto that Board, did Chair Gensler politicize the PCAOB and erode its independence?

Mr. BURTON. He certainly exercised the authority that the SEC has over the PCAOB.

Mr. HUIZENGA. In spades, yes.

Mr. BURTON. I actually think that the independence of a lot of these organizations—PCAOB, FINRA, MSRB—is sort of fictitious.

Mr. HUIZENGA. Okay. Yes, let me hit on that. I am not one to hand over authority to the SEC or any other regulator willy-nilly and without purpose and reason. But since the SEC already conducts oversight of the PCAOB, including approving the Board's rules, standards, and budget, it doesn't make a whole lot of sense to me that the PCAOB operate as a separate entity.

Mr. BURTON. But it does have an adverse effect, in that all of the protections we associate with government—the requirements with respect to regulatory analysis, due process, transparency, the Sunset Act, the Freedom of Information Act—none of that exists.

So, a lot of things that protect the public and enable you to conduct meaningful oversight over the PCAOB do not exist as it is currently structured. And your legislation would solve that problem.

Mr. HUIZENGA. And that is what I was getting at. I think, as we look at it, having the SEC's Examiners and its Chief Accountant absorb all of the PCAOB's responsibilities seems like a reasonable direction. Does that seem accurate to you?

Mr. BURTON. Absolutely.

Mr. HUIZENGA. Okay.

Chairwoman Wagner, I do want to thank you for attaching our bill, the Streamlining Public Company Accounting Oversight Act, to this hearing. That essentially would fold the PCAOB into the SEC.

And, as I said, I don't take handing over more authority to the SEC lightly, but we cannot call something independent if it is not actually independent. And this way, we would have the ability to hold to account the person who is actually running it, which is the Chair of the SEC.

And with that, I yield back.

Chairwoman WAGNER. The gentleman yields back.

And the Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you, Chairwoman Wagner.

Ms. Thornton, my friend, Chair Gensler, recently condemned artificial intelligence (AI) washing as the abuse of AI, when members of the financial sector make false charges about its use, stating that such activities could violate existing security laws.

And our regulators themselves have warned that some investment advisors and broker-dealers are quietly saying that they use artificial intelligence to generate higher returns on investments, and that executives at some publicly-traded firms are attempting to improve their stock prices by using AI.

And the SEC recently took steps to charge a number of companies which engage in this type of investor abuse with violating the existing Marketing Rule of the Advisers Act.

So, Ms. Thornton, I want to ask you, is this statute enough to ensure that the SEC continues to hold bad actors accountable? If not, what more can we do?

Ms. THORNTON. I think that its efforts in enforcing the marketing rules are very, very important, and can go a long way, and we have seen that it has brought cases like the one you mentioned.

But I think when it comes to AI, Chair Gensler has been very clear that there are possibly unique risks associated with AI that require us to take a closer look. He is deeply knowledgeable about AI, and I think that he is very interested in considering whether there are other rules that should be made.

Mr. SCOTT. Yes, but let me ask you this, because this is important. Artificial intelligence is here. It is here for our productive use. But how can we ensure that the SEC does not exhibit hostility towards technological innovation that could have a positive increase in our access to our markets among low-income and underserved investors?

Ms. THORNTON. I think that Chair Gensler has acknowledged the value of AI, the many good aspects of AI, and it is just a question of how you create the guardrails.

But I think it is important to make sure that any guardrails protect the very people you are talking about, who may not understand how it is being used.

But I am not a deep expert on AI, so that is probably about all I can say on that.

Mr. SCOTT. AI is with us.

Ms. THORNTON. It is.

Mr. SCOTT. And we have to make sure it serves us properly. And when used responsibly, I do believe that artificial intelligence has the unique and transformative potential to improve inclusion, efficiency, and user experience within our financial system.

We have the best financial system in the world, and the world depends on the United States' financial system as the bulwark in making sure this happens.

However, absent a robust regulatory regime addressing the rise in false and misleading statements regarding the use of intelligence technology, we risk hurting more investors.

And let me conclude by saying, this is sort of like the instrument that we created to serve us. We must not become servants of AI.

I yield back.

Mr. GARBARINO. [presiding]. The gentleman yields back.

The gentleman from Arkansas, Mr. Hill, who is also the Chair of our Subcommittee on Digital Assets, Financial Technology, and Inclusion, is now recognized for 5 minutes.

Mr. HILL. I thank the chairman.

And I thank our panel for being with us today.

We have heard directly from the SEC Director-level officials over the course of the last few months, and we have certainly enjoyed having Chairman Gensler here to have his point of view on behalf of the Commission.

So, it is great to have your expertise, and we thank you for being with us.

Not only has the SEC lost in the court of public opinion, even on a bipartisan basis here on Capitol Hill, but the agency is now getting trampled by the Federal courts as well, especially as it relates to digital assets. In July 2023, a New York judge determined that Ripple Labs did not violate Federal securities law by selling its XRP token on public exchanges. In fact, in that case, they were referred to as being arbitrary and capricious.

Last August, the court rejected the SEC's reasoning for blocking Grayscale Bitcoin Trust from converting to an exchange-traded fund.

And just in the last few days, a Utah judge imposed sanctions on the SEC for, "bad-faith conduct and gross abuse of power," that the Commission had demonstrated in a case against Dropbox.

This is important, because we haven't talked about this in a long time on this committee. And as a result of that gross abuse of power, the Commission is required to pay the legal fees, which means that our constituent tax dollars are now being used to pay for the SEC's overreach and failure.

So, whether it is refusing to comply with the Administrative Procedure Act (APA) or providing clear rules of the road for the digital asset ecosystem, it is clear that the SEC, under Gary Gensler, blatantly and repeatedly oversteps its statutory authority.

Our citizens are also very concerned about privacy and about their private information. We have seen the Office of Personnel Management (OPM) have a records leak. We have seen the IRS see constituent records leak. We have seen the Consumer Financial Protection Bureau (CFPB) collect transaction data on consumers and seen it leak. We have seen that the Financial Crimes Enforcement Network (FinCEN) now collects millions of records for beneficial ownership.

And, finally, the SEC is proposing to collect every American's brokerage account statement, every trade, every day, through their Consolidated Audit Trail (CAT). They have tried to work on this for a decade, but they are now planning to roll that out as we speak. FINRA President Robert Cook testified here that even his 80-year-old mother's information will be stored in the CAT, despite absence of any likelihood that an investor like his mom would try to manipulate the stock market.

So, Mr. Gulliver, let me start with you. What do you believe are the biggest cyber vulnerabilities of the CAT? What do you think are the biggest risks to the Consolidated Audit Trail from a cyber point of view?

Mr. GULLIVER. I think it is completely unnecessary for the CAT to store Social Security numbers for all U.S. investors, and there is a real risk there that it could be breached and this information would be exposed.

Mr. HILL. We have asked both Robert Cook at FINRA, and the SEC, what their plan is to protect that personally identifiable information (PII), and they have not really responded effectively with their plans.

Do you consider that, if they do store it, it is at risk for breach?

Mr. GULLIVER. Yes.

Mr. HILL. Ms. Schulp, as a former enforcement attorney at FINRA, can you explain why the SEC can still do its job effectively without collecting this personally identifiable information of investors through the CAT?

Ms. SCHULP. The SEC has been able to do it for years, and has continued to be able to do so with the transaction data without the personally identifiable information that has already been collected in the CAT.

Mr. HILL. Right.

Ms. SCHULP. The way it previously worked is that the SEC, upon noticing some sort of pattern or suspicious activity, would create a request for the investor's information to the brokerage firm.

Mr. HILL. Right. This is something that we have done for years. We have market surveillance of our exchanges, and we have surveillance of the activities of every brokerage firm, and we can do a sweep exam and get this information.

I really believe this is a huge expense that is unnecessary, which is why I support Congressman Barry Loudermilk's bill to protect that PII.

Let me stick with you. The cost estimate was originally $55 million to implement the Consolidated Audit Trail, and the most recent estimate is $250 million, increasing at the rate of 30 percent per year.

Who ultimately bears the expense of this item that you say is unnecessary?

Ms. SCHULP. The investors will.

Mr. HILL. I also think the investors will; I think it is a bad idea. I yield back.

Mr. GARBARINO. The gentleman yields back.

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

Mr. VARGAS. Thank you very much, Mr. Chairman. I appreciate the opportunity.

Again, I thank all of the witnesses for being here.

At the beginning of the hearing, I heard that we should talk about real-world impacts, and the SEC should be worried about real-world impacts and not theoretical stuff. And I agree with that.

How many of you believe in climate change? If you could raise your hand.

Okay. Did everyone raise their hand?

Yes. Okay. So, that is a real-world impact, then? I would say it is—if you all believe in it, I certainly do.

Yesterday, the Republican Chair of the Texas State Board of Education pulled $8.5 billion in investment from BlackRock. For years, BlackRock has outperformed the market and provided positive returns for the Texas Permanent School Fund, a fund specifically created to support the State's public schools. However, because of my good friends on the other side's anti-ESG dogma, cultural politics have been prioritized over the well-being of constituents.

And, unfortunately, this is not an isolated incident, but a trend. A recent study by the Texas Association of Business Chambers of Commerce Foundation found that Republican anti-ESG laws have cost Texas taxpayers an average of $270 million a year in debt-related costs since the measure took effect in 2021.

Thankfully, the Securities and Exchange Commission has decided to put people over politics and to listen to investors. Earlier this month, as we have been noting, the SEC adopted rules to enhance and standardize climate-related disclosures by public companies. These long-awaited rules require companies to disclose information about climate risks that have materially impacted their businesses' operations and strategy.

Additionally, companies must disclose costs, expenditures, and losses incurred because of severe weather events such as wildfires and flooding, which have drastically impacted my constituents in San Diego, and which we would have never thought would happen—a 1,000-year flood in San Diego. But it happened.

We know that climate risk is a financial risk. I applaud the SEC for considering feedback from investors, businesses, academics, industry experts, and Congress.

A recent Morgan Stanley Institute for Sustainable Investing report reflects that over 75 percent of individual investors believe

that corporations should address environmental impacts and plan to make sustainable investments based on those decisions.

Ms. Thornton, I agree with what you said earlier: Information is what makes capitalism work. This is information that I think is material, and investors want it.

Am I wrong about that? You were talking about that earlier. Isn't this what investors want these days?

Ms. THORNTON. Oh, absolutely. It has a profound impact, potentially, on companies.

Mr. VARGAS. Why does this have a profound impact?

Ms. THORNTON. For two reasons: one, the physical risks of climate change. We now know that these billion-dollar disasters are increasing. There is coastal flooding, and more is expected in the next 5 to 10 years. So, there is that. Companies that have operations in those areas are at risk and need to make a plan, and investors need to know that they have a plan.

But there are also transition risks, because there are all kinds of States changing laws, and creating laws that they hope to protect——

Mr. VARGAS. And there are even States where you can't even seem to get insurance these days, because the insurance companies take a look at these risks and say, "That is not a good risk for us. We are not going to insure. We can't get the right price." That is what is happening now.

I do want to talk, in my last minute and a half, about cost-benefit analysis. I do think that it is important to look at the cost of something. But how do you measure discrimination against women? What is the cost?

And, especially, let's say, a mother who is discriminated against because she is a woman, what is the cost to her daughters who are watching? How do you measure that?

Ms. THORNTON. You're absolutely right. It is difficult to measure many of the benefits of rules that are done that help people like that and it's difficult to measure many of the costs.

But the whole point of the cost-benefit analysis is not to get an absolutely perfect answer, but rather, to weigh things and get more information.

And the honest truth is that the SEC actually needs more high-level economists to be able to really do what folks on the other side want them to do on cost-benefit analysis, so they need a bigger budget.

Mr. VARGAS. And that is why—I am not against taking a look at the cost of things, but I guess you have to look at it holistically, because some of these things lead to really awful conclusions when you take a look at the cost of something.

Discrimination—you can say, "Well, that is not much of a cost. We will just get somebody else to do it. It doesn't have to be a woman." Well, you discriminated against her because she's a woman; that is not right.

But, anyway, with that, I have 7 seconds left, so I will yield back, and thank you.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Meuser, for 5 minutes.

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

And thank you all very, very much for being here with us.

Small businesses, the backbone of America's growth, do face significant barriers in accessing capital, including from excessive regulations, inflation, interest rates, new bank reserve requirements, loss of profits, scope requirements, and the list goes on and on.

The regulatory processes at the SEC have lacked inclusion, for lack of a better word, and do not foster trust and facilitate market participation. So, I have two pieces of legislation noticed in today's hearing aimed at addressing these issues, including the ACCESS Act, H.R. 6825, and a discussion draft of legislation that will increase accountability and provide transparency into important SEC staff-level actions.

Ms. Schulp, I would like to start with you, please. As you know, companies are required to file financial statements that are reviewed by independent public accounting firms if they conduct a regulation crowdfunding offering that exceeds $100,000.

My bill, H.R. 6825, the ACCESS Act of 2023, raises that threshold from $100,000 to $250,000, as was done without issue during COVID.

So I would just ask you, do you think this legislation will have a positive impact on small businesses that are considering raising money in a crowdfunding offering?

Ms. SCHULP. I believe so. And I think the fact that it was done without issue for more than 18 months during COVID is a sign that it was well-accepted and is a reasonable change to be made.

Mr. MEUSER. Great. And the fact that it sometimes will cost as much as $10,000 for all these small businesses to—for their accountants and other requirements to raise $100,000, that is a pretty steep percentage, would you agree?

Ms. SCHULP. Really, any additional cost that a small business needs to undertake to deal with its financial statements on that small of a capital raise is an undue burden.

Mr. MEUSER. Great. Thank you.

Mr. Gulliver, a discussion draft of legislation attached to this hearing could make certain actions by SEC staff, including Rule 14a-8, no-action letters and denials, review by the Commission, and require a report to Congress of their actions—we sent it to you. I am not sure, Mr. Gulliver, how familiar you are with it.

But, in doing so, the goal is to increase accountability, period, around such SEC actions that take place outside of the formal rulemaking process.

If you're familiar with what we have just recently sent you—and I appreciate it if you are—could you comment on this action?

Mr. GULLIVER. Yes. I think these no-action letters now are handled by the SEC staff through delegated authority from the Commission, and there is not a lot of transparency in how these decisions are made. They are made largely at the staff level. And I would be supportive of a bill that would enhance transparency of these decisions, especially when they have a major impact on the market.

Mr. MEUSER. Okay.

Not to be political, but have you found that these concerns of the process have been or could be politicized by SEC staff, especially with the ESG-related shareholder proposals?

Mr. GULLIVER. Yes, I certainly think these no-action letters in general can have a—can pertain to issues that are political. So, as the SEC staff——

Mr. MEUSER. Right. It just gets subjective at a certain point.

Mr. GULLIVER. Yes.

Mr. MEUSER. Right.

Mr. Burton, a question for you. On a scale of 1 to 10, how disruptive has the SEC's speed of new regulations and other actions been to capital markets and capital formation, this SEC, over the last 3 years and 2 months, on a scale of 1 to 10, or however you want to express it?

Mr. BURTON. I think there are two sides to that. In terms of the proactive regulatory agenda, it is a 9½ to 10. The climate change rules and then all the various things they have in their pipeline, and so on down.

But on the flip side, it is close to zero. Because you mentioned concern about entrepreneurs and small businesses starting to raise capital; there is a need to fix a lot of things, and the SEC has simply utterly failed to address the entrepreneurial capital formation issues, finders being an example, your crowdfunding rules. The SEC made the crowdfunding regulation much worse than it had to be, and so on down the line. It is a long, long list of failures of small businesses——

Mr. MEUSER. Wow.

Mr. BURTON. ——by the SEC.

Mr. MEUSER. My next question was going to be, on a scale of 1 to 10, how helpful, but I think you have just answered that.

I yield back, Madam Chairwoman. Thank you. I appreciate it.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the gentleman from Texas, Mr. Gonzalez, for 5 minutes.

Mr. GONZALEZ. Thank you, Madam Chairwoman.

And thank you to the panel for joining us today.

Mr. Gulliver, many on this committee have compared the SEC's recent rulemaking to throwing spaghetti at the wall and seeing what sticks.

Now, I am a strong supporter of increased regulation to maintain strong capital markets, but there is a balance to be struck, where you don't overregulate and stifle the ability of our markets to operate, and you don't underregulate, leaving avenues for investors to take excessive risks.

With that being said, how do you propose the SEC address these issues? And at what point do you believe legislation should be the answer, rather than rulemaking from experts?

Mr. GULLIVER. I think it would be important to take the economic analysis process more seriously. I think the SEC could use additional economists to help them with that process. But it should be sort of a—the economic analysis should be driving the policy decisions, rather than sort of coming after the fact and being more limited.

Mr. GONZALEZ. Thank you.

And my next question is for Mr. Burton.

Mr. Burton, you mentioned in your testimony that the SEC has set a precedent of short comment periods lasting less than the standard 60 days, especially for complex rulemakings. But I would be remiss to not mention that the SEC has been receptive to investor feedback and has reopened the comment period for some of the more-contentious rulemakings to allow for additional input.

I am just curious, what do you believe is the magic number for a comment period, in your eyes? And at what point should a rulemaking be 90 days versus 45 days? And what qualifications should we be using to set these deadlines?

Mr. BURTON. I think it depends on the nature of the regulation. If it is, say, just making an inflation adjustment as required by law, the comment period doesn't matter very much.

The APA actually has no minimum. But for something like an inflation adjustment, 30 days. For something that is a simple rule, easy to grasp, 60 days. And for some of these extraordinarily-complex ones, with hundreds of pages of text to absorb, I really think 120 days is appropriate. It simply depends on the nature of the regulation.

It is important that we get these things right. It is important that people have the opportunity to give the SEC meaningful comment, not just boilerplate. And I think, in some of these cases, they simply haven't given people enough time.

Mr. GONZALEZ. Thank you.

Are the extensions of the comment periods—have they created a better picture for the SEC of the proposed rules?

Mr. BURTON. Yes. They extended them, I think, under pressure from the public, and particularly industry, that they need more time to absorb the rules. And, in some cases, the SEC has been responsive to that by reopening the comment periods.

They haven't been universally bad about this, just too often.

Mr. GONZALEZ. Right.

Thank you. Thank you for your comments.

And I yield back.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the gentleman from Wisconsin, Mr. Steil, for 5 minutes.

Mr. STEIL. Thank you very much, Chairwoman Wagner.

I will start with you, Ms. Schulp, if I can.

One of the first things Chair Gensler did at the Securities and Exchange Commission was gut the proxy advisor rule that was put forward previously. And as we look at Commissioner Uyeda, he calls this type of action, "regulation by theory and hypothesis."

Would you agree that it is an unusual step for the SEC to take? And did it raise concerns about rule quality and legality, in your opinion?

Ms. SCHULP. It was an unusual step, and it does raise concerns. When the Commission has set its rule and finalized it, a new Commission coming in and immediately walking it back does not usually result in, I would say, good rulemaking.

Mr. STEIL. Thank you.

Let me follow up, then, with you, Mr. Gulliver, on the same topic. Do you think Chairman Gensler prejudged the outcome and

stopped a well-researched and important rule from being implemented?

Mr. GULLIVER. I think the decision came very, very early in his tenure, and it seemed to be rushed and have immediate effect and was a major concern.

Mr. STEIL. Thank you.

Mr. Burton, kind of on the same broader theme here, Chairman Gensler and the SEC's unwillingness to reign in proxy advisors, to me, is a larger effort to force politics into the boardroom. And what we are looking at as a loosening of the rules governing proxy advisors, to me, gives them a pass to push misguided, politically-motivated proposals, with really limited accountability.

Another factor in driving the politicization of investments is a new understanding by the left of materiality. So, based on this new understanding, the SEC has sought to deem more environmental, social, and governance (ESG) issues as de facto material.

Can you talk, really briefly, about the importance of materiality as a threshold, where we continue to see materiality gutted by those on the left?

Mr. BURTON. Both in the United States and already in Europe, there is an attempt to redefine materiality in a way much different than traditionally understood. Traditionally, it is material to financial risk and financial outcomes of corporations. Now, they are trying to redefine it——

Mr. STEIL. And why would somebody want to skip over a materiality threshold? In your research, why do you see that being done time and again?

Mr. BURTON. Yes. They are trying to redefine material as something a proxy advisory firm or a registered investment advisor, BlackRock, would care about, not whether it is material to the financial outcomes——

Mr. STEIL. But why would they care about it? For politically-motivated purposes?

Mr. BURTON. Absolutely, it is for political purposes, social, ideological——

Mr. STEIL. So, it doesn't help investors; it is purely someone driving a political——

Mr. BURTON. Correct.

Mr. STEIL. ——agenda. Is that your position?

Mr. BURTON. And fiduciaries are increasingly trying to throw their investors under the bus without their consent to achieve political objectives rather than investment returns.

Mr. STEIL. I agree.

I am going to come to you, Mr. Gulliver, if I can. I think it is the same theme.

We saw the Securities and Exchange Commission move forward Staff Legal Bulletin 14L, which makes it harder to exclude shareholder proposals on significant social policy questions, as determined by the SEC staff.

What is the impact that this is having? Does it raise transparency and accountability concerns to you?

Mr. GULLIVER. Yes. I think it just increases the burden on public companies. So, it is just one other reason why companies would rather stay private than go public.

Mr. STEIL. Does it provide a benefit to investors to analyze the financial or investment thesis of a business? Or is it simply being utilized to drive forward a political agenda?

Mr. GULLIVER. I think it definitely has political connotations.

Mr. STEIL. I think it is really concerning when we see staff at the SEC, under this legal bulletin, being able to run roughshod over what are historical and traditional mechanisms for making sure that we have proper oversight and guidance over companies. But, instead, leveraging that authority to drive forward a political agenda, I think is incredibly concerning.

With the 50 seconds I have left, Mr. Gulliver, in your opening remarks, you noted, I think, an important topic, and I would just like you to elaborate briefly on how Chair Gensler's SEC actions differ from those carried out under previous Chairs, and, in particular, how you think that the Chairman of the SEC is doing?

Mr. GULLIVER. Oh, Chair Gensler's actions—he has implemented substantially more rules than either of his predecessors, Chair White or Chair Clayton, and almost as many as Chair Schapiro, who was there during the financial crisis and the implementation of the Dodd-Frank Act. So, I think what we are seeing is pretty unprecedented in a time without a market crisis or new legislation.

Mr. STEIL. I thank you all for being here.

Madam Chairwoman, I yield back.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the gentleman from Illinois, Mr. Casten, for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman.

And thank you to our witnesses for being here.

I am struck that this hearing reminds me of what I have long felt about this job, that the single-loneliest position in Washington, D.C., is to be an advocate for competitive markets.

There is not a single business who comes to Washington, who pays their lobbyists, who pays the budget of The Heritage Foundation or the Cato Institute to say, "Can you please make my market safer for competitors? Can you please lower barriers to entry, lower barriers to exit, increase transparency of information?" Nobody does that.

And let none of us in this room ever trust someone who claims to be pro-market when all they are really doing is trying to protect the power of the powerful.

I say that just to say: Let's be honest here, as we get into this.

Mr. Burton, I am quite certain you and I disagree on whether the SEC's climate disclosure rule was a good idea. But hopefully, you do agree that the Commission did, in fact, receive significant public feedback and made adjustments in response to that feedback?

Yes? I see you nodding your head.

Mr. BURTON. Oh, definitely. They received a lot of comments.

Mr. CASTEN. Good. Okay. Because I saw that you said that the draft rule, in your opinion, would have raised costs by 300 percent. Now, you think it is 20 percent. Setting aside whether I agree with that—that sounds like a significant change—they did, in fact, respond to a lot of comments, and make adjustments, in response to a stakeholder process. Let's not forget that.

Ms. Schulp, in a podcast you did last week, you said that companies already provide a ton of voluntarily-disclosed financial information. I just want to be clear: That is not consistently described, right? They don't have a standard format? They are providing this in ways that they choose to describe, correct?

Ms. SCHULP. I was referring to climate-specific financial——

Mr. CASTEN. Yes. But they are not providing that in a consistent format?

Ms. SCHULP. Unless it is information that they are providing in SEC filings——

Mr. CASTEN. Which doesn't exist yet, right?

Ms. SCHULP. ——where they do define——

Mr. CASTEN. Because we don't actually mandate consistent format.

So, Ms. Thornton, can you please educate our economically moderately literate Members in the room why basic economics, why competitive markets, why investor protection demands that we provide consistent, accurate information?

Ms. THORNTON. Because if you don't standardize it somehow and make a format, investors may not be able to find it. If you don't tag the information, investors may not be able to find it in the voluminous 10-Ks that are filed.

And that information needs to be in a format where an investor can compare it one year to the next, so it is consistently reported from one year to the next, so the investor can see whether the company is making progress on the commitment that it made about reducing its emissions or whatever.

Mr. CASTEN. And isn't that true for all accounting? There are probably businesses which could make more money if they didn't have to comply with Generally Accepted Accounting Principles (GAAP) accounting.

Ms. THORNTON. Correct.

Mr. CASTEN. Right? It would probably be cheaper for them if they didn't have to have audited financials, wouldn't it?

Ms. THORNTON. Probably, but it wouldn't——

Mr. CASTEN. Does anyone think we should not have GAAP accounting?

I mean, my God, we are complaining that there is a cost of providing information. Free markets are awesome; sing it from the rafters. I hope that is not partisan someday.

Let me talk about a couple of things here, just for the record.

In 2020, the Trump Commodity Futures Trading Commission (CFTC) issued a report, "Managing Climate Risk in the Financial Sector," that said—and I quote—"Climate change poses a major risk to the stability of the U.S. financial system."

"Regulators and financial institutions need reliable, consistent, and comparable data and projections for climate risks, exposure, sensitivity...."

That was the Trump White House.

A 2021 report from the Financial Stability Oversight Council (FSOC) said that climate change is an emerging threat to the U.S. financial system.

And I could go on.

Show of hands, raise your hand if you agree that climate risk can pose a significant risk to the U.S. financial system.

Only the Democrats raised their hands. That is freaking insane, people.

You're going to deny—let me remind you, insurers are pulling out of Florida, they are pulling out of Louisiana, they are pulling out of Texas, and California. Who is left holding the bag? Those are billions of dollars. And we are going to somehow deny that this is real?

Look, I get it, you are protecting the interests of the powerful. Those of us up here have to represent everybody.

Mr. Burton, I understand that you are one of the authors of Project 2025, which provides a, "conservative blueprint for the next Republican President." Yes, that is true?

Mr. BURTON. I was a co-author of the Treasury chapter and the——

Mr. CASTEN. Okay. That is massively irresponsible.

I want to just point out in the time I have left, Richard Nixon created the EPA. Ronald Reagan's EPA said we need to use the markets to price environmental externalities. That led to the Montreal Protocol, a global agreement on pollution control. George H.W. Bush's White House extended that to the acid rain reduction program.

Do not be an embarrassment to the party of Nixon——

Chairwoman WAGNER. The gentleman's time has expired.

Mr. CASTEN. ——the party of Lincoln, the party of Reagan, the economic——

Chairwoman WAGNER. The gentleman's time has expired.

Mr. CASTEN. I yield back.

Mr. BURTON. I would be happy to talk to you——

Chairwoman WAGNER. The gentleman's time has expired.

And let me just say that I would caution all members of this committee to maintain the decorum that has always been consistent in the Financial Services Committee. We are a group——

Ms. WATERS. Will the gentlelady yield?

Chairwoman WAGNER. The gentleman——

Ms. WATERS. Will the gentlelady yield?

Chairwoman WAGNER. I absolutely will not.

I would like all to maintain decorum.

And the Chair now recognizes the gentleman from New York, Mr. Garbarino, for 5 minutes.

Mr. GARBARINO. Thank you, Madam Chairwoman.

And thank you to all the witnesses for being here today.

Mr. Burton, I will start with you. Under Chair Gensler, the SEC has proposed sweeping new regulatory requirements, often without a clear, data-driven need. We have seen this, from his overhaul of the regulations governing equity markets, to his plan to alter the liquidity risk management requirements for open-end funds.

Over this time, Commissioner Uyeda has often referred to this approach as—as we have heard before; it has been brought up several times—"regulation by theory and hypothesis."

Mr. Burton, would you explain some of the problems with Chair Gensler's rulemaking approach?

Mr. BURTON. For one, he is extraordinarily aggressive in terms of his objectives. And most of those objectives, on the important rulemakings, are not really related to the core mission of the SEC, the statutory charge of the SEC. They are to pursue environmental objectives. The human capital management rule that is in the regulatory pipeline is basically to pursue objectives that are more appropriate at the Department of Labor (DOL) or the National Labor Relations Board (NLRB), and so on down the line.

The corporate board diversity rule presumably will be something similar to the NASDAQ board diversity rule and impose racial, ethnic, or sex quotas on boards unless they explain why they didn't meet the quota. It is a form of racism, racism that I thought was a relic of the past.

So, you have that.

You also have the fact that the economic analysis at the SEC—and this predates Chairman Gensler—is becoming increasingly bad and not serious.

There is a fairly long list, but I don't want to take all your time.

Mr. GARBARINO. Actually, that was my next question, has the SEC's economic analysis suffered from Chair Gensler's pace of rulemaking? And you just said, yes, it is getting extremely bad. So, I appreciate that answer.

And I agree; I think he is treating everything as if it is a security. And he is putting out rules—there is another one; I know, Ms. Schulp, you brought it up—about the cybersecurity rule and his new one——

Mr. BURTON. On that, the SEC has operationally adopted the position that anything you buy for the purpose of making money is a security, which is, of course, not true. It can be real estate, it can be a commodity, or so on down the line.

Mr. GARBARINO. Absolutely.

And I wanted to bring up about the cybersecurity rule, we are now seeing what we thought was going to happen: The hackers are actually using this rule to their benefit and are reporting people that they are hacking to the SEC just to get them in trouble.

So, everybody agrees investor information is important, but not at the cost of national security. And I asked Mr. Gensler which was more important, and he did not seem to think that national security would suffer, but we are now seeing that.

But, Ms. Schulp, I wanted to bring back up—Mr. Hill, my colleague, had some questions before on the CAT. While the CAT is problematic on several fronts, I would first like to focus on its implications for American privacy.

The security concerns with collecting personally identifiable information was touched on, but I would like to provide you with the opportunity to further explain potential dangers of this practice.

Ms. SCHULP. Absolutely. And thank you for that.

The CAT is collecting all transaction information—buys, sells, cancellations—for every trade done in the United States, along with the personal information of the trader.

What that creates is a giant database of information about how investors are spending their money, which says a lot about people's beliefs, their desires, their political opinions, and the way they think that the country's economy is going to grow.

And that information is being required to be provided to the government, likely in violation of the Fourth and Fifth Amendments. And it raises First Amendment issues, as well, with this expressive speech and how people are investing.

That type of information should not be given to the government to scan at will to determine whether or not someone is investing in a way that the government feels is appropriate. That is a major privacy concern.

And that type of surveillance is something that we have largely rejected and we should continue to reject and not allow the SEC to go down that path.

Mr. GARBARINO. In addition to the PII concerns and privacy concerns, there are also cost concerns. Do you think we should move the CAT onto the SEC's budget?

Ms. SCHULP. I think that is a better way to start thinking about how to control the costs if the CAT were to go forward. Allowing the SEC to essentially dictate this new tax or fee on investors is contrary to the powers of the SEC. That should be something Congress is supposed to do, not the SEC. And if this were to go forward, it should be part of the SEC's——

Chairwoman WAGNER. The gentleman's time has expired.

Mr. GARBARINO. Okay. Thank you.

Chairwoman WAGNER. The Chair now recognizes the gentleman from North Carolina, Mr. Nickel, for 5 minutes.

Mr. NICKEL. Thanks so much, Madam Chairwoman, and thank you to our ranking member, and to our witnesses for being here.

While I applaud the great work of the SEC to protect investors, I have some concerns with the policy and the process surrounding the SEC's Staff Accounting Bulletin No. 121 (SAB 121).

My questions are more process-related. What we are seeing makes the digital assets industry less safe for consumers by preventing well-regulated banks from safeguarding digital assets owned by their clients.

Last October, the Government Accountability Office (GAO) concluded that the SEC breached statutory rulemaking requirements by issuing SAB 121. As it meets the Administrative Procedure Act's definition of a rule, it must be submitted to Congress for approval. That is why our committee passed a bipartisan Congressional Review Act resolution last month to eliminate SAB 121.

Mr. Gulliver, aren't staff accounting bulletins supposed to guide market participants in understanding and interpreting existing rules, rather than making new policies, as SAB 121 does?

Mr. GULLIVER. Yes, they should. SAB 121 is extremely harmful for investors in crypto markets. They benefit from having custody from well-regulated financial institutions, and SAB 121 prevents it.

Mr. NICKEL. What should the SEC have done differently?

Mr. GULLIVER. I think they should rescind SAB 121, and they should actually promulgate rules that would allow for the regulation of crypto exchanges so investors in crypto markets can be better protected.

Mr. NICKEL. I certainly agree. I hope they will withdraw the rule. I haven't heard any news about that happening anytime soon, but I think that would be a good way to go.

Moving on to the SEC's predictive data analytics (PDA) rule, I agree with the SEC's rationale for eliminating investor harm resulting from AI. However, I am worried about the rule's adverse effects on innovation and retail investors seeking inclusion in the financial system.

The proposal's scope is extremely broad and could be applied to virtually any technology used by broker-dealers and investment advisors. So, as we sit here today, I understand that the SEC is grappling with whether and how to narrow the rule's scope to be workable for market participants.

While I respect the work the Commission's staff is doing to try to get this right, the only recourse to address such an overly-broad and inherently-flawed rule is to withdraw and repropose it after adequate stakeholder engagement. I worry that the rule could be finalized with substantial changes and no public notice-or-comment period.

Mr. Gulliver, to you again, can changes be made to the rule without the SEC running afoul of the Administrative Procedure Act?

Mr. GULLIVER. No. I think finalizing that rule in any form would violate the APA. The final rule needs to be a logical outgrowth of the rule proposal, according to Federal law, and the rule proposal was so extreme that it couldn't possibly be finalized.

Mr. NICKEL. And, Mr. Gulliver, how has the SEC engaged with your members on this rule?

Mr. GULLIVER. I am not aware of the extent of communication between the SEC and our members on that. We have met, our staff, with the SEC to discuss this rule and shared views consistent with those that I just expressed.

Mr. NICKEL. And in terms of the process, what has been most concerning to you during this rulemaking process?

Mr. GULLIVER. I think one of the biggest issues—and you can see this for all of the SEC rulemakings—is that they are issuing these pretty extreme proposals and not consulting with market participants before doing so. So, that is how you get into this problem.

And that is not typical for the SEC. Past SECs, under Democratic or Republican leadership, typically have held public roundtables and consulted extensively with the market before a proposal was issued.

Mr. NICKEL. With all of the issues we have talked about, how could we here in Congress improve on the SEC's regulatory process?

Mr. GULLIVER. Well, a number of things: providing more opportunity for public comment; requiring the SEC to repropose a rule when a final rule would deviate too much from the proposal; and the various enhancements to the economic analysis process.

And I also think that having the Chair and the Commissioners speak to you all would be helpful.

Mr. NICKEL. Thank you so much.

Madam Chairwoman, I yield back.

Chairwoman WAGNER. The gentleman yields back.

And I now recognize the gentleman from New York, Mr. Lawler, for 5 minutes.

Mr. LAWLER. Thank you, Madam Chairwoman.

And thank you to our witnesses for being here and helping address our concerns on this important topic.

Like my fellow members of the committee, I am extremely alarmed by the pace and aggressiveness of the SEC rulemakings, which will add to the cumulative regulatory burden on companies in the U.S. economy.

To make matters worse, this constant stream of proposals has regularly been paired with concerns of regulatory overreach, theoretical assumptions and hypotheses, solutions in search of a problem, and the alarming absence of stakeholder input and meaningful cost-benefit analysis during the rulemaking process.

Chair Gensler's frenetic, partisan rulemaking agenda has threatened the health of U.S. capital markets, highlighting the need for targeted institutional reform.

Ms. Schulp, this hearing has a few bills attached to it intended to continue Committee Republicans' goal of spurring capital formation. Under Chair Gensler, the SEC has completely neglected this aspect of its statutory mission, opting instead to raise compliance costs and regulatory burdens.

What are the consequences of the SEC neglecting this important duty?

Ms. SCHULP. The consequences are terrible. In fact, when we have smaller businesses that are unable to raise capital, we don't have businesses that can continue to grow into bigger businesses. It creates a drag on the economy and creates a drag on the ability of investors to have companies to invest in as well.

Mr. LAWLER. Thank you.

And, as I alluded to earlier, a concern that goes with the flow of burdensome new proposals is the lack of meaningful consideration of stakeholder input.

Ms. Schulp, as someone who has written plenty of comment letters in response to SEC rulemakings, can you discuss the amount of time and work it takes to submit a comment letter addressing each of the SEC's questions while also evaluating their data?

Ms. SCHULP. I think it is impossible to address each of the SEC's questions in any given comment letter that they—and any given rule proposal they put out that often runs in the hundreds of questions. SEC rule proposals tend to run in the hundreds of pages, and this is a very burdensome task.

First, a company must determine—or a commenter generally must determine whether or not they are interested in commenting, and then prioritize their ability to comment on multiple letters at the same time.

Personally, as someone who writes comments, it takes 60 to 80 hours, minimum, for me to review and write a comment. The SEC would put my time as an attorney at about $600 an hour, which means that a comment letter costs somewhere between $36,000 and $48,000 to write. And I think that is a low-ball estimate.

And that is a big burden, particularly on smaller businesses, which don't have the staff or the resources to be able to outsource multiple comment letters at the same time. It really decreases the ability of a company to make a comment on a rule that might affect them.

Mr. LAWLER. In your opinion, why is the SEC acting inappropriately when it imposes substantial hurdles to prevent thoughtful public feedback?

Ms. SCHULP. The APA is built on thoughtful public feedback, and thoughtful public feedback is important to creating good public policy. Not allowing conditions where that can happen is a major problem.

Mr. LAWLER. Okay. Thank you.

I yield back.

Chairwoman WAGNER. The gentleman yields back.

The Chair now recognizes the gentleman from Iowa, Mr. Nunn, for 5 minutes.

Mr. NUNN. Thank you, Chairwoman Wagner.

And thank you to our witnesses for joining us today.

Like many members on this committee, the consequences of SEC rulemakings come up almost every day in my meetings with constituents, business leaders, and fellow Iowans. From Main Street to Wall Street, insurance firms in Des Moines, the cascading effects of rulemaking after rulemaking have negatively impacted their ability to not only do business but to serve their customers and their clients in my district.

Worse yet, it isn't just the SEC; it is the unelected bureaucrats from almost every agency that are causing regulatory havoc on our hometown communities. In fact, I believe, if this Administration gets its way, Madam Chairwoman, the SEC will finalize 63 new rules impacting Iowa companies in just 4 years. And it is just that one agency, the SEC, that has been blasted for its gross overregulation in this environment.

As was noted today, it is now easier for a company to work to sue and go to court to get regulatory clarity from these agencies than it is to deal with the massive costs of trying to make a compliance that may or may not fall in line with an ever-changing regulatory and rules system, particularly coming from the SEC.

And so, whether it is Chair Gensler's intention or not, the unintended consequences of his actions are very clear within the industry, making it impossible for small businesses, new businesses, innovative businesses, and long-time Main Street businesses just to keep their doors open.

The bottom line in my State is, I can say clearly, Madam Chairwoman, Iowans are suffering. So, I know my colleagues on both sides of the aisle are not going to continue to stand by and allow the regulatory overreach to be what defines it.

I would like to talk about both the insurance and the custody rules.

Mr. Gulliver, I am concerned about the SEC's expanding authority and its, often, role in superseding our State and local officials, who are really leaders in this area.

One example of this is the SEC's attempt to overhaul the custody rule and possibly include fee-based annuities within the scope of regulation. This would be unworkable within many of our State laws and would take authority from State insurance regulators, who have successfully overseen the insurance industry in my home State for over 150 years.

As a Member who represents an industry that is a critical component of our economy—in fact, 12 percent—I want to know if you can explain why this is a concerning trend, that Chairman Gensler should continue to push the boundaries of his authority well beyond their limits and infringe on State abilities to do this.

Mr. GULLIVER. I think the custody rule is another example of a proposal that really can't be finalized. It is just too extreme. It sweeps in assets that really can't be custodied in the way that the SEC would now require.

And the existing process for registered investment advisors and the custody that they provide their clients isn't broken. The SEC hasn't really established that there is a problem, either. So, the custody rule is a major problem.

Mr. NUNN. I would concur with you on that, Mr. Gulliver. I think you are right when you say it is not a rule that is broken. In fact, it is a rule that is well in hand for most of our State regulators.

Ms. Schulp, I would like to talk about AI and innovation, particularly in this area. I am concerned about the SEC's use of a blunt, one-size-fits-all approach to its rulemaking, particularly regarding new technologies coming on the market.

In Chairman Gensler's world, real-world analytics and cost-benefit analyses cease to exist. Just bad actors and broad-sweeping rules that do not allow our economy to flourish. In fact, in his world, everyone is a violator; it is just a matter of finding the right regulation to hold them accountable.

I guess I would be interested to hear that the Federal judge sanctioned the SEC's—what they identify in this regulation as a, "gross abuse of power," but beyond that, ultimately pay the price to shut down companies that the SEC has pushed away, shut down other companies here in America and push them overseas.

Just yesterday, Chairman Gensler said that, "powerful AI systems in the financial system make up the potential for an economic disaster, particularly acute here in the United States." This level of fearmongering is frightening.

Can you explain why the SEC's approach to rulemaking is chilling innovation or may even hurt technologies for decades to come?

Ms. SCHULP. This approach to regulation is absolutely the wrong one. And this is, I will say as a side note, an important reason why it is good to hear from the entire Commission, not just from the Chair, who gets the most airtime, in order to take these types of fearmongering statements about innovation.

Statements on AI, statements on crypto—all of these are making business environments in the United States much more uncertain, if not downright hostile. Other countries—the European Union, many in the Middle East, many in the Far East—are creating regulatory systems for crypto that are much more friendly and workable and, at the very least, are more certain——

Chairwoman WAGNER. The gentleman's time has expired.

Mr. NUNN. Thank you.

Chairwoman WAGNER. The Chair now recognizes the gentlewoman from Indiana, Mrs. Houchin, for 5 minutes.

Mrs. HOUCHIN. Thank you, Madam Chairwoman, and Ranking Member Sherman. And thanks to the witnesses for being here today.

Under Chair Gensler, we have seen the SEC move at an unprecedented pace to propose and then finalize politicized rulemakings that hurt our markets, discourage growth, and do nothing to help those who are saving for retirement or to better their lives.

From proposals like those on swing pricing and predictive data analytics that cut off tools and opportunities for everyday investors, to the recently-finalized rule on climate disclosures that goes well beyond the Commission's statutory authority and pushes a Green New Deal agenda, the SEC under this Administration has shown time and again that it is committed to pursuing ideological goals at the expense of ordinary Americans.

In my view, and that of many who serve on this committee, that has to change. With the number of wide-ranging effects that we have seen from the Commission under Chair Gensler, one of my foremost concerns is the way that the cumulative effect of this will change the way our U.S. capital markets work.

This issue goes well beyond just the SEC. We have also seen financial regulators become increasingly interested in implementing the initiatives of international organizations.

Between Basel III, the new environmental accounting standards coming out of the U.N., and the EU's Corporate Sustainability Directive, I am concerned that we don't fully understand yet the potential consequences that all of these rules will have on our markets.

Mr. Gulliver, what do you see are the potential consequences of implementing international policies without input from our market participants and stakeholders?

Mr. GULLIVER. I think there is a real risk that the policies that would be implemented in the U.S. wouldn't be in the United States' best interest. Our financial institutions and market participants have unique perspectives, and those need to be incorporated in rules here.

Mrs. HOUCHIN. Thank you. There is little need for us to take directives from outside the United States, especially as other proposals from our Federal regulators are threatening to change the ways that our markets current operate.

A few weeks ago, the House voted to pass Chairman McHenry's H.R. 2799, the Expanding Access to Capital Act of 2023. As a member of the Rules Committee, I was proud to manage the Floor debate on the rule that provided for its passage. It also included my legislation, the Regulation A-Plus Improvement Act, as part of the bill.

Together, these proposals would strengthen our public markets and expand opportunities for small and mid-sized businesses to raise capital and create new investment opportunities for everyday Americans.

This committee understands just how important capital formation is to creating new jobs and achieving economic growth. That is why I have been so upset at the SEC's direction under Chair Gensler, that they have neglected their statutory obligation and prioritized other items, like ideologically-driven climate reporting

mandates and crackdowns on investment advisers' use of basic technology over its obligation to promote capital formation.

Mr. Burton, are there better ways for the SEC to spend its limited resources rather than this hyper focus on achieving their partisan objectives?

Mr. BURTON. Yes. And I go into quite a bit of detail about that in my written statement. But the core function of the SEC is extraordinarily important to our capital markets, to the success of our economy, and to the standard of living in this country. And it needs to focus on that instead of pursuing these ideological and political objectives that are simply not related to the core mission of the SEC.

And it is about to get worse. If you look at the regulatory pipeline that they filed with ORIA, it is full of politically-motivated rules.

But also, the fact that the agency is so badly run. They waste so much money on things that are—it is not ideological; it is just incompetent. And they need to work on that as well.

There is one manager for every nonsupervisory employee at the SEC, for example; it is just bureaucratic and ineffective.

Mrs. HOUCHIN. And inefficient. Instead of prioritizing its congressionally-directed mission, they seem to be focused on squashing opportunities for growth, and adding more red tape for average investors, without any concern for the effects of all of this cumulative rulemaking and what that will do to the financial markets.

They also seem to be, as you stated, acting not only inefficiently but maybe incompetently on some of these fronts, and looking at things that, if I were a business owner seeking investments from other individuals, I would want to look at the bottom line and not necessarily the climate effect of what we have going on.

I appreciate the witnesses' testimony today, and I yield back to the chairwoman.

Chairwoman WAGNER. The gentlelady yields back.

The Chair now recognizes the gentlewoman from California, Mrs. Kim, for 5 minutes.

Mrs. KIM. Thank you, Chairwoman Wagner, for allowing me to waive onto this very important hearing, and for including my bill, H.R. 7030, the Review the Expansion of Government (REG) Act.

Since the spring of 2021, the SEC has proposed and finalized over 60 rules. When we compare the pace and scope of rulemaking with recent SEC Chairs, only former SEC Chair Shapiro has issued more rules than Chair Gensler.

My legislation, H.R. 7030, the REG Act, directs the SEC to review all rules every 5 years. And if the SEC determines that the rule is no longer appropriate or necessary to uphold its three-part mission, the SEC could revise or eliminate it.

In addition to the review process, my legislation would require the SEC to consider the cumulative effects of every rulemaking, which is something that Chair Gensler has failed to address.

Mr. Gulliver, your group has commented on the substantial overlap between many of Chair Gensler's rules. Even the Department of Justice has indicated that without an assessment of a rule's overlapping effects, the SEC cannot effectively assess the impact on investors, registrants, or the markets.

Mr. Gulliver, as you mention in your testimony, our capital markets are the largest and most efficient in the world. So, would you explain why the SEC's decision to review rules in isolation without considering their aggregate impact and interconnectedness can make our capital markets less efficient?

Mr. GULLIVER. I think there would be unnecessary compliance burdens. And I think, even more importantly, there will be conflicts between rules. And we are seeing that. We are seeing that the SEC's Securities Lending Rule and the SEC's Short-Selling Rule are directly in conflict. One requires disclosure on a daily basis, and the other would delay the disclosure of the very same financial activity for a month. Those are in conflict, and that is in court for that reason now.

Mrs. KIM. And how would market participants benefit from an understanding of how related proposals interconnect with each other?

Mr. GULLIVER. It would allow them to better understand their compliance burden, and to comply.

Mrs. KIM. So, would you agree that my legislation can help market participants, investors in capital formation?

Mr. GULLIVER. Yes. I think it is critical to look back and assess whether or not rulemakings are still serving their purpose. That is required in the EU now. And that would be an important way that the U.S. could remain competitive internationally.

Mrs. KIM. Right. I agree. My hope is that the SEC understands how each proposed rule can increase costs for smaller market participants.

Ms. Schulp, in your written testimony, you speak of a regularized process for revisiting some of the Commission's rules. And my legislation would establish a 5-year review process. Hopefully, you agree with the intent of my legislation. Can you elaborate on how a regular review process can help improve efficiencies in our capital markets?

Ms. SCHULP. A regular review process is important, because what it does is set a schedule. Rather than the political will of a particular Chairman, it requires every so many years the review to take place. And that is important, because you could very well see a situation where a general idea that we want to revisit rules just never happens when the political will is not there.

Taking a look back, particularly where cost-benefit analyses rely on speculative benefits or costs that are not yet able to be quantified is very important, because then, actual costs can be weighed against actual benefits to determine whether the rules are justified or serving their purposes.

Mrs. KIM. Thank you. Under Chair Gensler, the SEC has proposed sweeping new regulatory requirements, often without a clear, data-driven need. So this regulation, by theory and hypothesis approach, is blurring the regulatory lines between the private and public markets.

Ms. Schulp, as you know, the SEC's mission is to protect investors, maintain fair and efficient markets, and promote capital formation. However, the SEC, under Chair Gensler, seems to have neglected its statutory obligation and prioritized other factors over its obligation to promote capital formation.

What factors should the SEC be considering in its economic analysis to properly consider a rule's impact on capital formation?

Chairwoman WAGNER. The gentlelady's time has expired.

And I respectfully ask that the witness respond in writing. It is a very important question.

Mrs. KIM. Thank you very much.

Chairwoman WAGNER. I thank you all.

With that, the gentlelady yields back.

And we thank our witnesses for their testimony today.

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

I ask our witnesses to please respond as promptly as you are able.

And this hearing is now adjourned.

[Whereupon, at 12:11 p.m., the hearing was adjourned.]

A P P E N D I X

March 20, 2024

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CONGRESSIONAL TESTIMONY

"Reforming the SEC"

Testimony before
The Financial Services Committee
Subcommittee on Capital Markets
United States House of Representative

at a hearing on

"SEC Overreach: Examining the Need for Reform"

March 20, 2024

David R. Burton
Senior Fellow in Economic Policy
The Heritage Foundation

My name is David R. Burton. I am Senior Fellow in Economic Policy at The Heritage Foundation. I would like to express my thanks to Chairman Wagner, Ranking Member Sherman, and members of the committee for the opportunity to be here this morning. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

As the most important regulator of U.S. capital markets, the Securities and Exchange Commission has a vital mission.[1] We need an effective cop on the beat to prevent fraud, to ensure adequate disclosure and to promote efficient markets if we are to have strong capital markets, a vibrant economy and secure savings for the American people. Unfortunately, despite its glowing self-image, the Commission does an increasingly ineffective job of discharging its core functions. Moreover, although the Commission is statutorily required to promote efficiency, competition, and capital formation by responsible participants in the capital markets, it increasingly does the opposite.

There are at least five reasons for this. First, Commission resources have flowed into unnecessary management, "support," and ancillary functions, while core functions have been neglected. The SEC is managed exceedingly poorly and has been for quite some time. Its organizational structure is unwieldy and inconsistent with sound management practices. It is among the most management heavy and bureaucratic agencies in government. Its information technology function is among the most expensive and least effective in government. Oversight of its contracting process is poor. Second, it provides inadequate oversight of so-called self-regulatory organizations. In the aggregate, these non-governmental organizations to whom regulatory authority has been delegated, have personnel levels and budgets that are comparable to the SEC itself. Third, the Commission does an extraordinarily poor job of providing the information necessary for policy makers, whether Commissioners or members of Congress, to make informed judgments about the policy choices that they face. Fourth, the Commission has failed to address critical regulatory issues, opting instead to pursue regulation by enforcement or to largely ignore serious problems. Fifth, the Commission is pursuing political and ideological objectives that are unrelated to its core mission.

The first four of these problems have existed for quite some time but are growing relentlessly worse. The fifth – the extreme politicization of the Commission and its forays far beyond its statutory mission – is a new development and undoubtedly one of the reasons that this hearing is being held. I address these five problems in some detail and propose specific solutions. Because the Commission is floundering in so many different ways, major reforms are necessary to restore its effectiveness. Tinkering will not get the job done. I also address 13 specific bills that the Committee has asked me to discuss.

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[1] The Commission's statutory charge is: "Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." See Securities Exchange Act of 1934, Public Law 73–291, § 3(f), and Securities Act of 1933, Public Law 73–22, § 2(b). The SEC usually describes itself as having a three part mission: to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation.

The Commission is Poorly Managed and Core Functions are Neglected

Commission Spending and Staffing

One of the great myths surrounding the SEC is that it is under resourced. Its staff and budget have grown rapidly for two decades. The resources that it does have, however, are mismanaged. The table below shows SEC spending and staff levels for the past twenty years.

Securities and Exchange Commission Full-Time Equivalent Employees and Expenditures
(Fiscal Year 2004-2024; FY 2025 Request)

Fiscal Year	FTEs	Expenditures (billions)
2004	3,550	$0.76
2005	3,851	$0.89
2006	3,695	$0.89
2007	3,465	$0.88
2008	3,511	$0.91
2009	3,656	$0.96
2010	3,748	$1.10
2011	3,844	$1.21
2012	3,770	$1.18
2013	4,023	$1.28
2014	4,150	$1.42
2015	4,301	$1.55
2016	4,554	$1.68
2017	4,616	$1.65
2018	4,682	$1.65
2019	4,350	$1.70
2020	4,411	$1.83
2021	4,459	$1.95
2022	4,547	$2.02
2023	4,673	$2.19
2024	5,005	$2.15
2025 (request)	5,156	$2.59

Source: Securities and Exchange Commission, Congressional Budget Justification and Annual Performance Plan (various years)

During the past 10 years (FY 2014-2024), SEC spending has increased 51 percent. During the past 20 years (FY 2004-2024), SEC spending has increased by 183 percent. Over the same period, the price level (as measured by CPI-U) has increased by 32 percent (10 years) and 67 percent (20 years). Thus, SEC spending has been growing very substantially in real terms. Commission staff levels have increased by one-fifth during the past decade and by two-fifths over the past 20 years. The SEC has requested, and President Biden has included in his budget, a one-year increase of 20 percent for FY 2025.

Commission Resource Mismanagement

In FY 2023, the Office of Inspector General had 61 positions (51 FTEs), well over one percent of all SEC positions.[2] In FY 2008, the office had 11 FTEs.[3] So, in 15 years, its staff has grown 363 percent. It may be that this level of staffing is warranted by the level of malfeasance or other operational difficulties at the Commission. More likely, the staff level, which stood at 18 as recently as FY 2013, was ramped up and has not been seriously re-evaluated since by either the Commission or Congress due to bureaucratic and political inertia.

I have not had the opportunity to update my research in preparation for this testimony, but when I did my 2019 study of the SEC, the SEC spent massive amounts of money buying outside services for IT and for "support."[4] The SEC spent $377,529,843 in FY 2017 on contracts. This amounted to 23 percent of its FY 2017 spending and nearly $82,000 per employee. The overwhelming majority of these contracts fell into two categories: information technology and telecommunications ($186 million or 49.2 percent of obligated amounts) and "support" ($138 million or 36.5 percent of obligated amounts). Combined, these two categories amounted to 85.7 percent of all SEC contractually obligated amounts. Spending appears to be much too high and IT contracting poorly managed. There is almost certainly a great deal of room here to reallocate resources towards the SEC's mission and away from bureaucratic foolishness. Congress should require an Inspector General's report and a Government Accountability Office (GAO) report regarding Information Technology spending and "support" contracting by the SEC. The next SEC Chairman should look at this spending very, very closely and reallocate spending toward core mission functions.

The Commission has one of the most expensive, and least effective, information technology (IT) departments in government. The Commission had 211 information technology FTEs in FY 2023 up from 171 in FY 2017. This was 4.6 percent of its employees in FY 2023, up from 3.7 percent of its employees in FY 2017. When I did my 2019 study, total IT expenditures in FY 2017 were approximately $227 million, or nearly 14 percent of the commission's overall FY 2017 spending. This was *five times* higher than the government average of 2.8 percent. Since the Commission's IT FTEs have increased as a share of all FTEs and federal IT spending as a share of overall federal spending has not changed much,[5] the cost ineffectiveness of the SEC's IT department is probably worse, not better, than it was. I would have to conduct a thorough review of SEC IT contracting, as I did in 2019, to be sure.

The expenditure of all of this money might be warranted if the SEC's IT function was being competently discharged. It is not. The Electronic Data Gathering, Analysis, and Retrieval system (EDGAR) is the core mechanism by which SEC disclosure documents are provided to the public. It was established in 1984. It. Its search functions and user-friendliness have progressed little since the 1990s. Using EDGAR is a form of time travel because using it makes you feel like you

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[2] Fiscal Year 2025 Congressional Budget Justification and Annual Performance Plan https://www.sec.gov/cj .
[3] FY 2010 Congressional Justification https://www.sec.gov/files/secfy10congbudgjust.pdf .
[4] See David R. Burton, "Reforming the Securities and Exchange Commission, Heritage Foundation Backgrounder No. 3378, January 30, 2019, the section entitled "Contract Oversight and Spending" https://www.heritage.org/sites/default/files/2019-01/BG3378.pdf.
[5] As reported in Special Analysis 15 in Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2025 https://www.whitehouse.gov/wp-content/uploads/2024/03/ap_15_it_fy2025.pdf .

have traveled back to the 1990s. The system is so inadequate that most investors use private systems (based on EDGAR data) that display the information in a more useful and accessible format. In addition, the system has proved to be insecure. It was hacked in 2016.[6] This is highly problematic since the information in EDGAR documents can move markets considerably. Being able to access that information before it is made public could yield hackers considerable profit were they to trade on that information. The SEC X Account was also hacked in 2024.[7]

Commission Bureaucracy

The organization and structure of the SEC has not really been rethought for many decades. It shows. Under reorganization Plan No. 10 of 1950,[8] the Chairman has executive authority over the SEC budget, staff and, absent the rare statutory requirement, the structure of the SEC. Both the next Chairman and the Congress need to take steps to reform the SEC.

Both informal conversations with agency personnel and data support the proposition that the agency has become management heavy and overly bureaucratized. The SEC Office of Minority and Women Inclusion reports that the SEC had 918 Supervisors and Managers in FY 2022 which was 20 percent of its workforce of 4,547.[9] This means that 918 people are supervising 3,629 non-supervisory personnel, a ratio of one supervisor for every four non-supervisory employee. In most organizations, the ratio is between 5 to 1 and 10 to 1.[10] In the federal government generally, the average for all agencies is 7.6 to 1 (90 percent higher than the SEC).[11] Reducing the number of managers per non-supervisory worker will free up resources to better achieve the Commission's mission. Assuming the non-supervisory staff is competent, it will enable them to be more effective at their jobs by reducing micro-management.

Conversely, the number of direct reports to the SEC *Chairman* is absurdly high. At 23,[12] the SEC Chairman has approximately 2 ½ to three times the number of reports regarded as optimal. Nobody can effectively manage 23 people. The SEC should be restructured to reduce the number of direct reports to the Chairman. Specifically, the following offices should be merged into other offices and their managers made to report to an SEC official other than the Chairman:

1. Office of the Secretary;
2. Office of the Ethics Counsel;
3. Office of International Affairs;

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[6] News release, "SEC Chairman Clayton Issues Statement on Cybersecurity," U.S. Securities and Exchange Commission, September 20, 2017 https://www.sec.gov/news/press-release/2017-170 .
[7] See "SECGov X Account" https://www.sec.gov/secgov-x-account.
[8] Title 5, United States Code, Appendix, Reorganization Plans, pp. 140-141 https://www.govinfo.gov/content/pkg/USCODE-2018-title5/pdf/USCODE-2018-title5-app.pdf . See also 15 U.S. Code §78d-2.
[9] SEC Office of Minority and Women Inclusion, Annual Report to Congress, March 2023, p. 42 https://www.sec.gov/files/omwi_annual_report_fy2022.pdf .
[10] See, for example, Gary L. Neilson and Julie Wulf, "How Many Direct Reports?," *Harvard Business Review* (April 2012), https://hbr.org/2012/04/how-many-direct-reports .
[11] 2,260,354 total employees and 261,972 supervisors. (2,260,354-261,972)/261,972 = 7.63 October 2023. Federal Workforce Data https://www.fedscope.opm.gov/ .
[12] For a list, see David R. Burton, "Reforming the Securities and Exchange Commission, Heritage Foundation Backgrounder No. 3378, January 30, 2019, pp. 7-8 https://www.heritage.org/sites/default/files/2019-01/BG3378.pdf.

4. Office of the Chief Accountant;
5. Office of Credit Ratings;
6. Office of Municipal Securities;
7. Office of Public Affairs;
8. Office of Legislative and Intergovernmental Affairs;
9. Office of Equal Employment Opportunity;
10. Office of Minority and Women Inclusion; and
11. Office of Investor Education and Advocacy.

The Office of the Secretary, the Office of the Ethics Counsel, and the Office of International Affairs should be merged into the Office of the General Counsel. Alternatively, all or some functions of the Office of International Affairs could be moved to the Division of Corporate Finance. Legal functions, such as providing ethics advice and enforcement, providing legal advice to the Commission regarding Commission procedures, and administrative law and international comparative law and coordination should be unified under one chief legal officer, the General Counsel. The Office of Municipal Securities should be merged into either the Division of Corporate Finance or the Division of Trading and Markets. The Office of the Chief Accountant should become an office within the Division of Corporate Finance and their functions integrated. The primary duty of the Office of the Chief Accountant involves financial accounting disclosures. That, combined with nonfinancial accounting disclosure, is also the core function of the Division of Corporate Finance. The Office of Credit Ratings also plays a key function in the disclosure process, particularly with respect to debt securities and ensuring the integrity of the rating process by rating organizations. It also should become an office within the Division of Corporate Finance. The Office of Public Affairs and the Office of Legislative and Intergovernmental Affairs discharge allied functions. They should be integrated into a single office. There is no need to have two separate directors reporting separately to the Chairman. The director of the new office could also report to someone other than the Chairman such as the Chief of Staff.

These changes would reduce the number of direct reports to the Chairman from 23 to 12. Most of these changes can be undertaken by the Chairman because of the authority granted by Reorganization Plan No. 10 of 1950.

The offices still reporting directly to the Chairman would be:

1. Division of Corporation Finance;
2. Division of Investment Management;
3. Division of Enforcement;
4. Division of Trading and Markets;
5. Division of Economic and Risk Analysis;
6. Division of Examinations;
7. Office of the General Counsel;
8. Office of the Chief Operating Officer;
9. Office of Administrative Law Judges;
10. Office of Inspector General;
11. Office of the Investor Advocate; and

12. Office of the Advocate for Small Business Capital Formation.

The Office of the Investor Advocate and the Office of the Advocate for Small Business Capital Formation are required by law to report to the Chairman. Congress may want to reconsider that. To me, the important thing regarding these offices is not to whom the advocates report but whether they have the authority to communicate directly to Congress and to the public on substantive policy matters without getting prior approval of the SEC bureaucracy.

Poor SRO (and PCAOB) Oversight

So-called self-regulatory organizations (SROs) include The Financial Institution Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB) and the regulatory functions of the national securities exchanges such as the NYSE and NASDAQ.[13] The Public Company Accounting Oversight Board (PCAOB), while a "non-governmental" not-for-profit regulator like FINRA, is not usually considered an "SRO" but it operates in a similar fashion. Furthermore, SROs are no longer actually "self-regulatory" because their boards are not member controlled as they once were.[14] In other words, the term SRO is now a misnomer.

In the aggregate, FINRA, PCAOB and the exchanges have more personnel conducting regulatory functions than the SEC and combined budgets roughly comparable to the SEC. Yet, Congressional oversight of these regulators is nothing close to the oversight conducted on the SEC. And the oversight of these regulators conducted by the SEC is highly inadequate.[15]

FINRA – a so-called self-regulatory organization or SRO[16] – is the primary regulator of broker-dealers and their registered representative employees. FINRA is currently the only registered national securities association. It has been delegated regulatory authority by the SEC and Congress. FINRA is organized as a not-for-profit Delaware corporation. It regulates roughly 621 thousand registered representatives and about 3,400 broker dealers. Its board has industry members but the board is not controlled by the industry. FINRA is supervised by the SEC and its rules must be approved by the SEC. It spent about $1.42 billion in 2023.[17] This is about two-thirds of the SEC budget. In 2023, it had 4,200 employees, 90 percent of the SEC staffing level.

FINRA is largely unaccountable to the industry or to the public. Due process, transparency, and regulatory-review protections normally associated with regulators are not present, and its rulemaking and arbitration process are flawed. Reforms are necessary.[18] Despite its importance,

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[13] The National Futures Association is the SRO (and FINRA analog) in the derivatives field.
[14] Neither FINRA nor the MSRB have a majority of directors from the industry. Both the New York Stock Exchange and NASDAQ are now investor owned, not member owned.
[15] The FINRA and Securities Industry Oversight (FSIO) Examination Program in the Division of Examinations is primarily responsible for this oversight along with the Division of Trading and Markets and the Office of Municipal Securities.
[16] FINRA is not actually a self-regulatory organization since its board is not controlled by the industry. See also Hester Peirce, "The Financial Industry Regulatory Authority: Not Self-Regulation After All," Mercatus Center at George Mason University Working Paper, January 2015, https://www.mercatus.org/research/working-papers/financial-industry-regulatoryauthority-not-self-regulation-after-all .
[17] FINRA 2023 Annual Budget https://www.finra.org/sites/default/files/2023-06/FINRA-2023-Annual-Budget-Summary.pdf .
[18] David R. Burton, "Reforming FINRA," Heritage Foundation Backgrounder No. 3181, February 1, 2017,

Congress provides little meaningful oversight of FINRA. And the oversight provided by the SEC is highly insufficient. Thus, the second most important regulator of the capital markets, and the most important regulator of financial services providers, operates largely free of meaningful oversight. That is a serious problem.

FINRA has proven to be largely impervious to reform and, given its governance structure, that is unlikely to change. Accordingly, FINRA's regulatory function (which is most of what it does) should be moved to the SEC.

In the absence of merging FINRA into the SEC, as recommended, Congress (or the SEC) should require that:

1. FINRA's Board of Governors meetings be open to the public unless the board votes by a supermajority to meet in executive session.
2. FINRA's Board of Governors' agenda be made available to the public in advance.
3. FINRA's Board minutes describing actions taken be published without delay.
4. FINRA make available to the public in advance rulemakings that the FINRA board is expected to consider.
5. FINRA arbitration and disciplinary hearings should be open to the public and reported.
6. FINRA arbitrators make findings of fact based on the evidentiary record and demonstrate how those facts led to the award given (except with respect to very small claims). These written FINRA arbitration decisions should be subject to SEC review and limited judicial review.
7. All fines imposed by FINRA (and other SROs) should go either to a newly established investor reimbursement fund or to the Treasury. SROs should not have a financial interest in imposing fines.
8. All SROs conduct meaningful cost-benefit analysis as part of the rulemaking process with respect to major rules.
9. All SROs publish rules in proposed format, seek public comment and respond to those comments before they are submitted to the SEC.
10. All SROs submit an annual report to Congress with detailed, specified information about their budget and fees, their enforcement activities (including sanctions and fines imposed by type of violation and type of firm or individual), their dispute resolution activities, and their rulemaking activities.
11. Congress conduct annual oversight hearings for each SRO.
12. Either (a) FINRA, the Municipal Securities Rulemaking Board (MSRB), and the National Futures Association (NFA) are "Designated Federal Entities" and an inspector general is established with respect to financial SROs (including FINRA, the MSRB, and the NFA) or (b) place FINRA, the MSRB, and the NFA within the ambit of an existing inspector general.
13. The SEC publish a detailed annual report on SRO supervision.

FINRA reform or replacement is an area of potential agreement between progressives and conservatives. The Committee should explore this opportunity to work together.

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https://www.heritage.org/sites/default/files/2017-02/BG3181.pdf .

Created by Congress with the Sarbanes-Oxley Act, the Public Company Accounting Oversight Board (PCAOB) is another largely unaccountable regulator.[19] It has about 800 employees (18 percent of the SEC) and a budget of about $300 million (15 percent of the SEC budget).[20] Although it is deemed a not-for-profit corporation, its board is appointed by the SEC. The SEC has oversight authority over the PCAOB, including the approval of the Board's rules, standards, and budget. Most of the due process, transparency and rulemaking protections associated with government are not present. Oversight by both Congress and the SEC is not robust.[21] PCAOB, like FINRA, should be rolled into the SEC. Its creation was a mistake. Rep. Huizenga's Streamlining Public Company Accounting Oversight Act, discussed below, would accomplish this result.

MSRB is much smaller than FINRA or the PCAOB. It spends about $40 million annually and has about 125 employees.[22] I do not have readily available information about the budgetary and personnel aspects of the regulatory functions of the exchanges. In terms of their impact on the markets, however, they are extremely important.

Information Desert

Commissioners and Congress operate in an almost data free environment because the SEC is so bad at collecting and publishing relevant data. Data available to the Commission and Congressional policymakers with respect to securities markets, securities offerings, securities market participants and securities law enforcement is seriously deficient. This becomes evident when what is available to the Commission and Congress in the securities regulation field is compared to, for example, the Internal Revenue Service Statistics of Income and IRS Databook relevant to tax policy,[23] the data provided with respect to health care by the National Center for Health Statistics, the Centers for Medicare & Medicaid Services and others,[24] the data provided regarding labor and employment by the Bureau of Labor Statistics and others,[25] education data,[26] transportation data[27] and the general economic data provided by the Bureau of Economic Analysis[28] or the Census[29] and so on.

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[19] Peter J. Wallison, "Rein in the Public Company Accounting Oversight Board," American Enterprise Institute, February 1, 2005 https://www.aei.org/research-products/report/rein-in-the-public-company-accounting-oversight-board/.
[20] PCAOB, 2022 Annual Report https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/annual_reports/2022-annual-report_final.pdf .
[21] At the very least, Congress should require a detailed annual report from the SEC regarding its supervision of the PCAOB and hold an annual oversight hearing requiring the PCAOB and those at the SEC who oversee it to testify.
[22] MSRB, Form 990, 2022 https://www.msrb.org/sites/default/files/2023-08/FY-2022-Form-990.pdf .
[23] Tax Statistics https://www.irs.gov/statistics.
[24] The National Center for Health Statistics https://www.cdc.gov/nchs/index.htm; The Centers for Medicare & Medicaid Services (CMS), Research, Statistics, Data & Systems https://www.cms.gov/Research-Statistics-Data-and-Systems/Research-Statistics-Data-and-Systems.html.
[25] Bureau of Labor Statistics https://www.bls.gov/; National Labor Relations Board. Graphs & Data https://www.nlrb.gov/news-outreach/graphs-data; U.S. Equal Employment Opportunity Commission, Statistics https://www.eeoc.gov/eeoc/statistics/.
[26] National Center for Education Statistics https://nces.ed.gov/.
[27] Bureau of Transportation Statistics https://www.bts.gov/.
[28] Bureau of Economic Analysis http://www.bea.gov/.
[29] Census Bureau, Data Tools and Apps https://www.census.gov/data/data-tools.html.

The Division of Economic and Risk Analysis (DERA) should substantially improve the collection and regular publication of data on securities offerings, securities markets and securities law enforcement and publish an annual data book of time series data on these matters. With a budget of about $89 million and about 168 employees, it has adequate resources to do so. It should conduct surveys and collect information internally available (both data from filings and from enforcement actions). It should publish on a regular basis time series data in compliance with OMB's Standards and Guidelines for Statistical Surveys and the Paperwork Reduction Act.[30] DERA should consult with the Office of Management and Budget (OMB) Office of Information and Regulatory Affairs (OIRA) and the Interagency Council on Statistical Policy and secure advice from key statistic agencies such as the Census Bureau and the Bureau of Economic Analysis regarding the most effective means of collecting information and protecting the privacy of those providing the information.

Specifically, Congress should require DERA to publish annual data on:

> (1) the number of offerings and offering amounts by type (including type of issuer[31], type of security[32] and exemption used[33]);
> (2) ongoing and offering compliance costs by size and type of firm and by exemption used or registered status (e.g. emerging growth company, smaller reporting company, fully reporting company) including both offering costs, the cost of ongoing compliance and fees imposed by federal and state regulators;
> (3) enforcement (by the SEC, state regulators and SROs), including the type and number of violations,[34] the type and number of violators and the amount of money involved;
> (4) basic market statistics such as market capitalization by type of issuer and type of security; the number of reporting companies, Regulation A issuers, crowdfunding issuers and the like; trading volumes by exchange or ATS; and
> (5) market participants, including the number and, if relevant, size of broker-dealers, registered representatives, exchanges, alternative trading systems, investment companies, registered investment advisors and other information.

This data should be presented in time series over multiple years (including prior years to the extent possible) so that trends can be determined.

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[30] Statistical Programs & Standards, Directives and Standards, OMB Directives 1-4 https://www.whitehouse.gov/omb/information-regulatory-affairs/statistical-programs-standards/ .
[31] By industry; by measures of size such as gross revenues, assets or employees; by age (i.e. years in existence); reporting status; and so on.
[32] Common stock, preferred stock, bond, (and whether the bond or preferred stock is convertible into common stock), other classes of security, whether options or warrants were attached; and so on.
[33] Regulation D (Rule 504 and 506 (including 506(b) and 506(c)); Regulation A (Tier 1 and Tier 2); Crowdfunding (Tiers 1, 2 & 3); non-Regulation D section 4(a)(2) offerings, Rule 144A and other exemptions.
[34] Civil or Criminal (referrals, convictions, settlements); with respect to broker-dealers (Breach of Fiduciary Duty, Suitability violations, Negligence, Failure to Supervise, Misrepresentation, Fraud, Breach of Contract, Omission of Facts, Violation of Blue Sky Laws, Unauthorized Trading, Manipulation, Churning); issuer violations by type of violation (e.g. fraud, non-compliance with Regulation S-K, Regulation S-X, failure to file an 8-K, Regulation A, Regulation CF, etc.) and type of issuer ((private issuer, Regulation A issuer, crowdfunding issuer, reporting company, investment company, registered investor advisor, broker-dealer, registered representative, etc.).

Failure to Address Important Regulatory Issues and Regulation by Enforcement

The Commission is no slouch when it comes to imposing rules, interfering in markets and increasing costs borne by market participants. But, in a number of areas, it has also acted irresponsibly by refusing to develop rules – engaging instead in regulation by enforcement or simply largely ignoring a problem. I will discuss three areas in particular: digital assets, finders and private placement brokers and entrepreneurial capital formation.

Digital Assets

Perhaps the leading area in which the Commission has been irresponsible is the area of digital assets, or crypto assets. For over a decade, it has failed to provide basic rules for responsible actors to follow. I am not entirely sure whether this irresponsible failure to provide basic rules is a function of the limited understanding of those charged with regulating in this area or their desire to simply have no rules so that the Commission can engage in regulation by enforcement. It has tried to crush the adoption of new technologies. And yet it has also failed to protect investors from massive fraud and misappropriation by politically connected bad actors in the digital asset area. If you were to write a book on how not to regulate, the Commission's *modus operandi* in this area would be the first chapter. And the Commission leadership continues to plod blithely along as if nothing is wrong with their approach.

For over a decade the Commission has not bothered to promulgate basic rules governing the area or even provide meaningful guidance. It's one attempt is a complete failure. Its 2019, 13-page "Framework for 'Investment Contract' Analysis of Digital Assets" [35] is an attempt to apply the Supreme Court Howey test (from a 1946 case relating to orange groves) to digital assets.[36] Although the actual decision is not so concise, the test is usually articulated as "an 'investment contract' exists when there is the investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others." The reason that matters is that an "investment contract" falls with the definition of a security under the Securities Act.[37] The Howey test is, therefore, a four-prong test. Making an investment in art, other collectibles, any commodity or reals estate involves (1) the investment of money and (2) the expectation of profit that is (3) derived from the effort of others. Ergo, for purposes of evaluating whether digital assets are a security, the key issue is whether buying it involves an investment in a common enterprise (i.e. a business). In a 13-page document, this is the entirely of the SEC's discussion of the common enterprise prong of the Howey test:

> Courts generally have analyzed a "common enterprise" as a distinct element of an investment contract. In evaluating digital assets, we have found that a "common enterprise" typically exists.

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[35] Framework for "Investment Contract" Analysis of Digital Assets, April 3, 2019 https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets or https://www.sec.gov/files/dlt-framework.pdf (PDF).
[36] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).
[37] Securities Act of 1933, sec. 2(1).

Nobody at the SEC has *ever* explained what equity interest, what debt interest or what interest at liquidation any owner of bitcoin, for example, has in any common enterprise. That is because there is none. But if you don't have an equity interest in a common enterprise, or a debt interest in a common enterprise, or an interest upon liquidation of the common enterprise, then you don't have an interest in a common enterprise.

Yet the SEC marches along as if all of these assets should be registered securities and their issuers should treat them as stocks or bonds. It has launched over 225 enforcement actions.[38] To be sure, there is real fraud in this space. Both the SEC and the CFTC need to police actual fraud, most of which would be fraud or misappropriation under common law principles even in the absence of the Securities Act, the Securities Exchange Act or the Commodity Exchange Act. But the SEC and the CFTC failed to protect investors from the biggest such fraud, the multibillion FTX fraud perpetrated by the politically connected[39] Sam Bankman-Fried.[40] The SEC did not get involved until FTX was collapsing.[41]

Finders and Private Placement Brokers

Another example of irresponsible regulating by the SEC relates to finders. A finder, or private placement broker, is a person who is paid to assist small businesses to find capital by making introductions to investors. Finders are particularly important to Main Street small business people who do not have access to many highly affluent accredited investors. In 2000, the Securities and Exchange Commission created a regulatory cloud surrounding finders, and entrepreneurs that use finders to raise capital, by withdrawing the relevant guidance and declaring that finders would be pursued as unregistered broker-dealers (even though many of them are no such thing) and that issuers that raised capital using finders may have to rescind those transactions.[42] Although there was one attempt late in Chairman Clayton's tenure to resolve this Commission-created problem, the Commission has never done so.[43] Legislation to provide a safe harbor for finders and a reasonable regulatory regime for more active private placement brokers passed the House earlier this month. It would resolve the problem and have a substantial

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[38] Crypto Assets and Cyber Enforcement Actions https://www.sec.gov/spotlight/cybersecurity-enforcement-actions.
[39] Nik Popli, "Here's What We Know About Sam Bankman-Fried's Political Donations," *Time*, December 14, 2022 https://time.com/6241262/sam-bankman-fried-political-donations/.
[40] Luc Cohen and Jody Godoy, "Sam Bankman-Fried convicted of multi-billion dollar FTX fraud," Reuters, November 3, 2023 https://www.reuters.com/legal/ftx-founder-sam-bankman-fried-thought-rules-did-not-apply-him-prosecutor-says-2023-11-02/ .
[41] "Sam Bankman-Fried and the SEC," Editorial, *Wall Street Journal*, November 3, 2023.
[42] David R. Burton, "Let Entrepreneurs Raise Capital Using Finders and Private Placement Brokers," Heritage Foundation Backgrounder No. 3328, July 10, 2018 https://www.heritage.org/sites/default/files/2018-07/BG3328.pdf.
[43] "Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders," Securities and Exchange Commission, *Federal Register*, Vol. 85, No. 198, October 13, 2020 https://www.govinfo.gov/content/pkg/FR-2020-10-13/pdf/2020-22565.pdf; "SEC Proposes Conditional Exemption for Finders Assisting Small Businesses with Capital Raising," SEC Press Release, October 7, 2020 https://www.sec.gov/news/press-release/2020-248 .

positive impact on the ability of Main Street entrepreneurs to raise capital.[44] We can hope that the Senate will follow suit and put an end to this Commission-created confusion.

Entrepreneurial Capital Formation

The Commission has, for a very long time, stood in the way of entrepreneurs seeking to raise capital to launch or grow their business. The 2012 JOBS Act, signed into law by President Obama, was a bi-partisan effort to scale back these obstacles. With a few exceptions, the Commission has remained intransigent. It typically only takes action on these matters when forced to do so by Congress.[45] It consistently makes it more, rather than less, difficult for small businesses to raise capital. Even its regulations implementing JOBS Act provisions are highly complex and bureaucratic, imposing unnecessary burdens. There is serious need for reforms in this area by both the SEC and Congress. Elsewhere, I have made detailed suggestions for improvements.[46] I should also note that the SEC is working on a potentially highly destructive amendment to Regulation D that may radically reduce the number of persons that can invest in Regulation D offerings, harming investors, and harm the ability of entrepreneurs to raise capital.[47]

Regulatory Agenda Driven by Politics Rather than Core Mission

The SEC's Mission

Under Chairman Gensler, massive amounts of Commission and Commission staff time and resources are being diverted to ideological projects that are unrelated to the Commission's statutory charge, which is:

> Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[48]

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[44] The "Unlocking Capital for Small Businesses Act of 2023" was incorporating into the "Expanding Access to Capital Act of 2023" [H. R. 2799, 118th Congress] as Title I of Division B which passed the House on March 08, 2024.

[45] This can take the form of the Commission grudgingly implementing statutes by piling on unnecessary requirements or preemptively adopting a no-action letter, for example, to try to take the momentum from a Congressional reform effort.

[46] See, for example, David R. Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation Backgrounder No. 3182, February 14, 2017 https://www.heritage.org/sites/default/files/2017-02/BG3182.pdf; David R. Burton and Norbert J. Michel, "Proposals to Foster Economic Growth and Capital Formation," Submission to U.S. Senate Banking Committee, March 18th, 2021 https://www.banking.senate.gov/download/david-burton-and-norbert-michel; David R. Burton, Comments regarding the Concept Release on Harmonization of Securities Offering Exemptions, September 24, 2019 https://www.sec.gov/comments/s7-08-19/s70819-6193328-192495.pdf.

[47] See Regulation D and Form D Improvements https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202310&RIN=3235-AN04 .

[48] See Securities Exchange Act of 1934, Public Law 73–291, § 3(f), and Securities Act of 1933, Public Law 73–22, § 2(b).

Entirely independent of the merits of his ideological objectives, this pursuit of ideological objectives unrelated to the SEC mission has real world consequences simply because the Commission is not doing its real job but is instead focusing on climate regulation, diversity equity and inclusion, board diversity and various social justice objectives under the rubric of human capital management.

The Commission is a securities regulator. Its mission is to protect investors and promote efficiency, competition and capital formation. It is not meant to right every imaginable social wrong, nor can it do so. It is not an environmental regulator. It is not the EEOC or the Civil Rights Commission. It is not the Department of Labor or the NLRB. It should discharge the mission that Congress gave it.

Materiality

The concept of materiality has been described as "the cornerstone" of the disclosure system established by the federal securities laws.[49] The Supreme Court has held that information or facts (or omitted information or facts) are material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.[50] The Court has also indicated that information is material if there is a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information available.[51]

There is no definition of material or materiality in the Securities Act or the Securities Exchange Act although the term "material" is used in both many times. The Commission has defined the term "material" in its regulations and changed its definition over the years (often to conform to Supreme Court holdings). The current definition found in 17 CFR § 240.12b-2 is:

> Material. The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.

These definitions are fine as far as they go but they are quite general and provide little practical guidance to issuers. There is a spirited debate about whether "principles-based" or more "prescriptive," bright-line rules should govern disclosure by issuers of material information. The Commission's rules presently balance these two approaches.

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[49] SEC Concept Release on Business and Financial Disclosure Required by Regulation S-K, April 13, 2016 at p. 33 https://www.sec.gov/rules/concept/2016/33-10064.pdf; "Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission," Committee Print 95-29, House Committee on Interstate and Foreign Commerce, 95th Congress, 1st Session, November 3, 1977 http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1970/1977_1103_AdvisoryDisclosure.pdf.

[50] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976); *Basic Inc. vs. Levinson*, 485 U.S. 224 (1988).

[51] *Matrixx Initiatives, Inc. v. Siracusano*, 131 U.S. 1309 (2011).

There is now a major effort to effectively redefine what is material to include information that is really directed at achieving various social or political objectives. In other words, the information would be deemed material if a woke fund investment advisor or proxy advisory firm deems it "important," or would like to see the information, whether or not the information has any bearing on the financial results of the issuer.[52] The European Union has already gone down this path, calling it "double materiality."[53]

Instead, the focus of the materiality standard in the United States should remain on what actual investors need to know to meet their financial, economic or pecuniary objectives, not the preferred political or social objectives of investment advisers, corporate managers or regulators at the SEC. The vast majority of underlying beneficial owners in investment funds and the vast majority of direct shareholders care about the returns earned in their retirement and other accounts and not whether the political objectives of the Commission, their advisors or corporate management are being met. While investors are free to invest in funds or corporations that explicitly sacrifice returns to achieve political objectives, few do so.[54]

Congress should statutorily define materiality in terms generally consonant with Supreme Court holdings on the issue making it clear that the term refers to financial returns and financial risks. It should also specifically exclude social and political objectives unrelated to investors' financial, economic or pecuniary objectives.[55] Investors would remain free to invest in funds or corporations that explicitly state that they are seeking to achieve political or social objectives by

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[52] See, for example, Allison Herren Lee, "Living in a Material World: Myths and Misconceptions about 'Materiality,'" May 24, 2021 https://www.sec.gov/news/speech/lee-living-material-world-052421 (especially, the discussion of "Myth #4: Climate and ESG are matters of social or "political" concern, and not material to investment or voting decisions) and Brian Tomlinson and Lucy Godshall, "Doubling Down: ESG Regulation Gives Materiality a Bigger Stake," Ernst & Young LLP, August 22, 2023 https://www.ey.com/en_us/assurance/esg-regulation-gives-materiality-a-bigger-stake.

[53] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (see especially paragraphs 29, 37 and 39 of the 'whereas' preamble) https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022L2464.

[54] See, for example, Shane Shifflett, "Wall Street's ESG Craze Is Fading: Investors Pulled More than $14 billion from Sustainable Funds this Year," *Wall Street Journal*, November 19, 2023.

[55] This could be accomplished by amending section 2 of the Securities Act to define "material" as follows:

> "(20) The term "material" means, when used to qualify a requirement for the furnishing of information as to any subject, information limited to those matters regarding which there is a substantial likelihood that a reasonable investor would attach importance when –
>
> (i) evaluating the potential financial return and financial risks of an existing or prospective investment, or
>
> (ii) exercising, or declining to exercise, any rights appurtenant to securities for the purpose of earning a financial return or managing financial risk.
>
> The term "material" does not include, when used to qualify a requirement for the furnishing of information as to any subject, information that –
>
> (i) primarily furthers non-pecuniary, non-economic or non-financial social, political or ideological goals or objectives, or
>
> (ii) primarily relates to events that –
>
> (A) involve a high degree of uncertainty regarding what may or may not occur in the distant future, and
>
> (B) are systemic, general or not issuer specific in nature.

sacrificing return. But the funds, investment advisers and issuers would no longer be able to misrepresent what they are doing.

The Merits of the SEC's Ideological Agenda

On the merits, while the proposed climate change rules would have had a devastating impact on U.S. capital markets, the final rule will simply have a highly negative impact.[56] The final rule raises costs by about 20 percent as opposed to the proposed rule's 300 percent. The final rule will have no material impact on the climate. Its only material effects will be (1) to enrich lawyers, accountants, climate consultants and NGOs. (2) to raise the cost of capital and (3) make it harder for entrepreneurs to access public capital markets.[57] Those effects are not consistent with the mission of the SEC.

The adopting release is 886 pages long and contains 3,241 footnotes. The final rule requires public companies to report their "Scope 1" and "Scope 2" emissions of greenhouse gases expressed in metric tons of carbon dioxide equivalent. Greenhouse gases are defined to include carbon dioxide, methane, nitrous oxide, nitrogen trifluoride, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride. Scope 1 emissions are direct greenhouse gas emissions from operations that are owned or controlled by the reporting company. Scope 2 emissions are indirect emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a reporting company. All of this is in addition to the existing EPA Greenhouse Gas Emissions Reporting Program that covers emissions from more than 8,000 facilities in the United States and about 85% to 90% percent of total emissions.

The rule also requires detailed reporting regarding oversight by the board of directors and management of climate-related risks, transition plans, scenario analysis, or internal carbon prices. It requires reporting information about a reporting company's climate-related targets or goals, carbon offsets and renewable energy credits or certificates and a host of other matters. It imposes requirements to report large amounts of immaterial information that has a trivial impact on company finances—but is of interest to climate activists. As Commissioner Peirce wrote in her dissent, "While the Commission has decorated the final rule with materiality ribbons, the rule embraces materiality in name only. The resulting flood of climate-related disclosures will overwhelm investors, not inform them."

The rule explicitly creates a new profession. Firms must hire so-called "GHG emissions attestation providers." These providers, in turn, will be certified by "oversight inspection programs" run by left-wing nongovernmental organizations. Those providers and NGOs will then become a potent lobby dedicated to preserving the SEC's climate rule and the revenue stream of the attestation providers and NGOs.

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[56] David R. Burton Comment Letter to the SEC re: The Enhancement and Standardization of Climate-Related Disclosures for Investors June 17, 2022 https://www.sec.gov/comments/s7-10-22/s71022-20131980-302443.pdf.
[57] David Burton, "Legal Challenges Follow SEC Adoption of Costly, Burdensome Climate Rule," March 12, 2024 https://www.dailysignal.com/2024/03/12/sec-adopts-destructive-climate-rule/.

The final rule will have a pronounced negative effect on entrepreneurs and average investors. By increasing the cost of becoming a public company by at least 20%, it will make it more costly to access public capital markets. Fewer companies will be able to raise the capital needed to launch and grow, and they will do so later in their life cycle. That effect has been observed for the past two decades as the number of initial public offerings and the number of public companies declined because the regulatory burden on public companies steadily increased. It also means that ordinary investors will have less opportunity to invest in successful, growing entrepreneurial ventures. Most of the profits will have been made while the company was still a private company. Access to private offerings by ordinary investors is generally barred by the SEC.

On the merits, the SEC's approval of NASDAQ's racist board diversity rule is deeply disappointing.[58] Specifically, Nasdaq now requires each of its listed companies, subject to certain exceptions, to provide statistical information regarding "diversity" among the members of its board, and to either have, or explain why it does not have, at least two "diverse" directors on its board. "Diverse" would mean a director who self-identifies as female (without regard to the individual's biological sex), self-identifies as an under-represented minority, or self-identifies as LGBTQ+. Nasdaq defines an underrepresented minority as black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities. The rule is inconsistent with the principles underpinning the Civil Rights Act of 196414 which makes it an unlawful employment practice for an employer to "limit, segregate, or classify his employees…because of such individual's race, color, religion, sex, or national origin." It is also a violation of the equal protection principles of the United States Constitution. Quotas, such as those instituted by the rule, are particularly suspect constitutionally. Discrimination on the basis of race, ethnicity, national origin or sex should be a relic of the past. That the SEC[59] and the FDIC[60] are considering going down this path is troublesome.

The Human Capital Management[61] proposed rule is more likely to read like a DOL, NLRB or EEOC release than a securities regulation.

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[58] David R. Burton, "Nasdaq's Proposed Board-Diversity Rule Is Immoral and Has No Basis in Economics," Heritage Foundation Backgrounder No. 3591, March 9, 2021 https://www.heritage.org/sites/default/files/2021-03/BG3591_0.pdf.

[59] Corporate Board Diversity https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202310&RIN=3235-AL91.

[60] Comment Letter of David R. Burton to the Federal Deposit Insurance Corporation re: Guidelines Establishing Standards for Corporate Governance and Risk Management for Covered Institutions with Total Consolidated Assets of $10 Billion or More February 9, 2024 https://thf_media.s3.amazonaws.com/2024/Regulatory_Comments/Comment%20Letter%20of%20David%20R%20Burton%20re%20FDIC%20Guidelines%20Establishing%20Standards%20for%20Corporate%20Governance%20and%20Risk%20Management%20020924.pdf .

[61] Human Capital Management Disclosure https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202310&RIN=3235-AM88 .

Analysis of Specific Legislation

1. Streamlining Public Company Accounting Oversight Act (Rep. Huizenga)

This draft legislation would close the PCAOB and return its functions to the SEC by creating an Office of Public Accounting Oversight in the Office of the Chief Accountant of the SEC.[62] The Chief Accountant would serve as the Director of the Office of Public Accounting Oversight. It retains the basic functions of the PCAOB but houses them within the SEC. Thus, it would have the salutary effect of increasing the oversight and accountability of those discharging these functions and make the due process, transparency and regulatory process protections normally associated with government apply once again to this area of regulation.

2. SEC Regulatory Accountability Act (Rep. Wagner)

This draft legislation would codify in the Securities Exchange Act, using well-drafted language, the requirement to conduct rigorous cost-benefit analysis in the rule-making process, a very robust and detailed retrospective review process and, effectively, regulatory flexibility analysis. It would apply these requirements not only to the Commission but also to FINRA and MSRB in that the Commission would be unable to approve FINRA and MSRB rules unless the Commission determines that FINRA or MSRB complied with the requirements. In effect, the bill would impose a process similar to that required of non-independent agencies under Executive Order 12866.[63] It would codify and extend Regulatory Flexibility Act requirements. The legislation is likely to force the SEC to more seriously evaluate the costs and benefits of proposed and existing regulations and more seriously explore less burdensome alternatives. Furthermore, applying these requirements to FINRA and MSRB is well past due. FINRA, especially, is a highly important regulator and it has been able to regulate with only a passing nod to serious economic analysis.

The retroactive review provisions are robust and likely to make a difference. The legislation would require the Commission's Chief economist to establish an assessment plan, with specified metrics and data collection provisions, and require a post-adoption impact assessment conducted in accordance with those specifications within two years. They will also provide Congress with very useful information.

3. Reviewable Action (Rep. Meuser)

This proposed legislation appears to me to be constructive in that it creates additional information and transparency relating to Commission delegation of authority. This is, of course,

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[62] On a technical note, if this legislation were to pass, I might reconsider my proposal, above and elsewhere, to place the Office of the Chief Accountant within the Division of Corporate Finance (made in an effort to reduce the number of direct reports to the SEC Chairman).

[63] The Trump Administration's Department of Justice issued an opinion that the President has authority to require independent agencies to comply with Executive Order 12866 but Executive Order 12866 was not amended. See Extending Regulatory Review Under Executive Order 12866 to Independent Regulatory Agencies, October 8, 2019 https://www.justice.gov/olc/opinion/extending-regulatory-review-under-executive-order-12866-independent-regulatory-agencies ; Henry B. Hogue, Baird Webel and Marc Labonte, "Independence of Federal Financial Regulators: Structure, Funding, and Other Issues," Congressional Research Service, August 3, 2023.

how a lot of the Commission's day to day work gets done. I am, however, not an expert on the finer points of Commission delegation of authority.

4. Review the Expansion of Government (REG) Act [H. R. 7030] (Rep. Kim)

This bill has laudatory intentions and may actually help. Similarly, the requirement that the Commission consider the cumulative cost of regulations has laudatory intentions and I certainly support anything that is designed to force them to holistically consider the impact of the massive regulatory edifice that has been erected by the Commission over the years. Unfortunately, generalized retroactive review requirements, however, have had a very limited real-world impact in the past because agencies have simply not taken them seriously.

5. Private Fund Advisers (Rep. Mooney)

The SEC private fund advisers final rule,[64] adopted in August of 2023, is highly burdensome and prescriptive.[65] It will add substantial operating expenses that will harm, rather than protect, investors since those costs will be reflected in lower returns and higher fees. The Commission's economic justification for the rule is inadequate. Its statutory foundation is also highly questionable. This Congressional Review Act resolution of disapproval would reverse the rule and put an end to its counterproductive effect.

6. Information Technology Study (Rep. Wagner)

As I discussed above in some detail, the SEC's information technology programs are among the most expensive and least effective in government. Therefore, I welcome the draft legislation's requirement that the GAO "perform an independent audit of the information technology infrastructure." I would welcome the opportunity to work with the committee to refine the requirements of the GAO study of the SEC's IT systems.

7. International Securities Standard Setting Bodies Meetings

This draft legislation would require the SEC to disclose to Congress discussions and meetings between staff of the Commission and international securities standard setting bodies, who participated in the meetings and what was discussed. Given the importance of these bodies and their increasing, and not always constructive, influence on American law, increased transparency would appear to be warranted.

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[64] Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Final Rule https://www.govinfo.gov/content/pkg/FR-2023-09-14/pdf/2023-18660.pdf .

[65] These two statements outline in detail the problems with the rule. Commissioner Hester M. Peirce, "Uprooted: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," August 23, 2023 https://www.sec.gov/news/statement/peirce-statement-doc-registered-investment-adviser-compliance-reviews-08232023; Commissioner Mark T. Uyeda, "Statement on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," August 23, 2023 https://www.sec.gov/news/statement/uyeda-statement-private-fund-advisers-082323.

8. Cost Benefit Analysis Study

I am very sympathetic to the objectives of this draft legislation. It would require that the GAO conduct a study of the costs of up to 10 major rules and compare the GAO estimates to those made by the Commission staff. I think it is very important to try to start establishing some independent analysis of the Commission's economics work since it is clear to me at this point that it is entirely inadequate and needs serious improvement. The SEC, FinCEN and the banking agencies all do a very poor job of estimating costs (or benefits) and the economic impact of proposed rules. Sometimes the work is embarrassingly bad. There was effectively no rational economic argument for the monstrously complex and prescriptive Basel III endgame proposed rule[66] and a recent FinCEN economic analysis was arithmetically impossible.[67] The economic analysis in the SEC's climate change rule was a little more sophisticated but it boiled down to this: (1) disclosure requirements can have positive economic externalities, (2) this rule requires disclosure, (3) ergo, this rule may have positive externalities. Once stripped of all of the verbiage and obfuscation, the analysis was entirely unconvincing. The economic analysis in the proposing release appeared to be oblivious to the fact that tripling or quadrupling the cost of being a public company, as the proposed rule would have done, would have devastating negative effects while the impact of the proposed rule on climate change would be non-existent.[68] It is becoming increasingly obvious that many of these agencies just do what they have to do to give an economic analysis patina to the proposed rulemaking. In fact, I am increasingly coming to believe that for cost benefit analysis to be impartial and more accurate, we probably need to seriously rethink the institutional arrangements governing how it is done.

9. Amendment for Crowdfunding Capital Enhancement and Small-business Support (ACCESS) Act [H. R. 6825] (Rep. Meuser)

This bill would increase the threshold before reviewed financial statements are required in a crowdfunding offering from $100,000 to $250,000. Tax returns and financial statements certified by the top executive of the issuer would still be required. It is an appropriate change to the scaling requirement that would only affect the smallest of issuers.

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[66] David R. Burton Comment Letter to the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation re: Regulatory Capital Rule: Large Banking Organizations with Significant Trading Activity January 16, 2024 https://thf_media.s3.amazonaws.com/2024/Regulatory_Comments/Comment%20Letter%20of%20David%20R%20Burton%20re%20Basel%20III%20Endgame.pdf ("In a 316-page proposing release making 160 pages in CFR changes, containing about 74 complex formulas and over 25 tables assigning risk weights to various types of assets and operations, the economic analysis runs 4 ½ pages long. A reader of this economic analysis will search in vain for a justification of the various assigned risk weights or an analysis of why the chosen formulas and models are appropriate or any better than the models or formulas used by banks that they will replace. Such justification is not provided. The reason is probably that it simply does not exist but that instead the entire rulemaking is an exercise of arbitrariness.").

[67] See "Economic Analysis" section of David R. Burton Comment Letter to FinCEN re: Beneficial Ownership Information Reporting Requirements, February 7, 2022 http://thf_media.s3.amazonaws.com/2022/Regulatory_Comments/FINCEN-2021-0005-0438_attachment_1.pdf.

[68] David R. Burton Comment Letter to the SEC re: The Enhancement and Standardization of Climate-Related Disclosures for Investors June 17, 2022 https://www.sec.gov/comments/s7-10-22/s71022-20131980-302443.pdf.

10. Minimum Public Comment Period

This draft legislation would generally require, with an emergency exception, that the comment period for proposed SEC rules be at least 60 days. This is entirely warranted. Anything less simply does not give the public sufficient time to become aware of the proposed rule, read it, think through its implications and write a comment.

11. Semiannual Testimony (Rep. Wagner)

This draft legislation would require the Chairman of the Commission to testify to the House Financial Services Committee and the Senate Banking Committee at least twice annually and for other Commissioners to do so once annually. I think this makes sense and will facilitate a more active exchange of views between Commissioners and Congress that both should find beneficial. It will help to better inform the public and should result in more robust oversight of the Commission. I see little downside to the provision, although I am sure that some Chairman may find the additional scrutiny by elected officials to be unwelcome.

12. Protecting Investors' Personally Identifiable Information Act [H. R. 4551] (Rep. Loudermilk)

This bill provides welcome protection for investors' personally identifiable information and would probably effectively end the very misguided SEC Consolidated Audit Trail program.[69]

13. Protecting Private Job Creators Act [H. R. 7092] (Rep. Mooney)

I do not have any particular knowledge with respect to the markets or regulations governing fixed-income securities sold pursuant to Rule 144A, so I am unable to comment on this bill.

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[69] David R. Burton, "Why the SEC's Consolidated Audit Trail Is a Bad Idea," December 5, 2019 https://www.heritage.org/monetary-policy/commentary/why-the-secs-consolidated-audit-trail-bad-idea.

Testimony of

John A. Gulliver

Executive Director of the Committee on Capital Markets Regulation

Before the

Subcommittee on Capital Markets

Of the

Financial Services Committee

United States House of Representatives

Wednesday, March 20, 2024

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Thank you, Chair Wagner, Ranking Member Sherman, and members of the Subcommittee for inviting me to testify before you today on the topic of "SEC Overreach: Examining the Need for Reform." My name is John Gulliver, and I am the Executive Director of the Committee on Capital Markets Regulation. My testimony today is my own and does not necessarily reflect the views of the Committee on Capital Markets Regulation ("CCMR") or its members.

The United States more than any other nation depends on its capital markets to fuel economic growth and prosperity. Our capital markets are the largest and most efficient in the world because they are highly competitive and innovative. The Securities and Exchange Commission is tasked with the vital role of regulating approximately 3,600 public companies with a market capitalization

of $47 trillion,[1] as well as the broker-dealers and investment advisers that provide 76 million U.S. households with an opportunity to invest in our markets and earn a return on their savings.[2] It is therefore critical that the SEC deliver on its mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[3]

Under Chair Gensler's leadership, the SEC has embarked on an unprecedented rulemaking agenda that will radically redesign the regulation of our securities markets and will have a major impact on the cost of being a public company and investing in our markets. Damage to the U.S. capital markets would also mean damage to the U.S. economy. The SEC is risking this outcome without a new statutory mandate or market crisis presenting a need for such holistic reform. Now is therefore precisely the time to consider whether reforms to the SEC's regulatory process are needed to ensure that such regulatory actions are consistent with the SEC's mission.

1. The SEC's Regulatory Agenda is Unprecedented

CCMR staff has prepared a comprehensive review of the SEC's rulemaking agenda under Chair Gensler. **Table 1** demonstrates that the SEC has proposed or finalized 48 substantive rulemakings since Chair Gensler entered office on April 17, 2021.[4] Of these rulemakings, 38 (or 79%) were *not* required by congressional statute, meaning that the overwhelming majority of the SEC's rulemaking agenda has been voluntarily undertaken.

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[1] *See, e.g.*, CENTER FOR RESEARCH IN SEC. PRICES, *CRSP Market Indexes: US Market Update* (Jan. 2024), https://www.crsp.org/wp-content/uploads/2024/03/CRSP_Market_Update_-_January_2024.pdf; WORLD FEDERATION OF EXCHANGES, *Statistics Portal* (2023 annual data), https://statistics.world-exchanges.org/.

[2] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Changes in U.S. Family Finances from 2019 to 2022: Evidence from the Survey of Consumer Finances* (Oct. 2023), https://www.federalreserve.gov/publications/files/scf23.pdf.

[3] SECURITIES & EXCHANGE COMMISSION ["SEC"], *Our Goals* (Apr. 6, 2023), https://www.sec.gov/our-goals.

[4] Substantive rulemakings exclude rulemakings that are routine, administrative and procedural, such as filing fee adjustments.

Critically, the SEC's rulemaking activity has many overlapping effects on each type of market participant, as demonstrated by **Appendix I**. For example, 14 rulemakings apply to public companies and 12 apply to investment companies. Yet, the SEC has conducted no comprehensive analysis of how those rulemakings will collectively impact public companies or investment companies. Furthermore, the SEC's economic analysis for each rule ignores any overlapping effects or conflicts with other proposed rules.

Moreover, the SEC's latest Regulatory Flexibility Agenda continues to chart an ambitious course toward additional rulemaking activity to come, including rules on corporate board diversity, human capital management disclosure, incentive-based compensation arrangements, credit rating agencies, proxy process amendments, index providers, and a host of other substantive areas.[5]

CCMR staff has also compared the overall incidence of rulemaking during Chair Gensler's term to the rulemaking agenda over the comparable time period for each of the past three chairs, i.e., Mary L. Schapiro, Mary Jo White, and Walter "Jay" Clayton. As set forth in **Table 1**, in contrast to Chair Gensler's 48 proposed and final substantive rulemakings, Schapiro, White, and Clayton issued 66, 31, and 40 proposed and final substantive rulemakings, respectively.

Chair Gensler's rulemaking count therefore substantially exceeds his immediate predecessors, Chair Clayton and Chair White. It is particularly instructive to compare Chair Gensler's tenure with Chair Schapiro's term, which began in the immediate aftermath of the 2008 failure of Lehman

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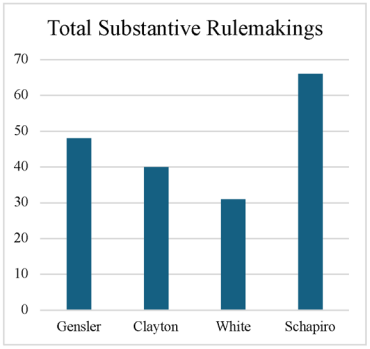
[5] *See* OFFICE OF INFORMATION & REGULATORY AFFAIRS, *Agency Rule List - Fall 2023 (Securities and Exchange Commission)*, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode&showStage=active&agencyCd=3235 (last visited Mar. 14, 2024); OFFICE OF INFORMATION & REGULATORY AFFAIRS, *Agency Rule List - Fall 2023 (Securities and Exchange Commission) for Long-Term Actions*, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPubId=202310&showStage=longterm&agencyCd=3235 (last visited Mar. 14, 2024).

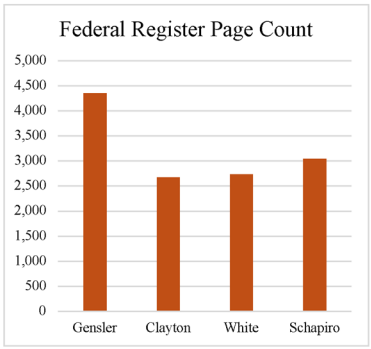
Brothers, included the ensuing global financial crisis and market crash, and culminated in the passage and implementation of the Dodd-Frank Act. Chair Schapiro's term was therefore necessarily going to involve substantial rulemaking activity. However, the Gensler chairmanship is only slightly lower in terms of total rulemaking actions than Chair Schapiro's term thus far, and, most importantly, 56% of Chair Schapiro's actions were statutorily mandated compared to only 21% of Chair Gensler's rulemakings. Moreover, Chair Gensler's rulemakings are particularly complex as demonstrated by the fact that their total regulatory page count in the *Federal Register* exceeds that of Chair Schapiro's tenure by nearly 50%.

Table 1: Substantive Proposed and Final Rulemakings by Recent SEC Chairs

(for each, the first 1,063 days of their term)

SEC Chair	Covered Dates	Proposed Rules	Final Rules	Total Substantive Rulemakings	Number of Rules Mandated by Statute	Federal Register Page Count
Gensler	April 17, 2021 to March 15, 2024	21	27	48	10 (21%)	4,357
Clayton	May 4, 2017 to April 1, 2020	25	15	40	7 (18%)	2,680
White	April 10, 2013 to March 8, 2016	21	10	31	20 (65%)	2,736
Schapiro	January 27, 2009 to December 26, 2011	40	26	66	37 (56%)	3,050





2. The SEC's Regulatory Process

The SEC's regulatory process is governed by the Administrative Procedure Act of 1946 (the "APA") which imposes a set of uniform procedural requirements on all federal agencies, requiring that: (a) agencies provide the public notice of proposed rules and an opportunity to comment on them ("notice-and-comment procedures");[6] (b) agencies publish their final rules;[7] and (c) agency actions be subject to judicial review and reversal if they fail to comply with the APA's procedural requirements or are otherwise "arbitrary and capricious."[8] The objective of the APA is to "achieve relative uniformity in the administrative machinery of the federal government,"[9] and to "ensure[] that the massive federal bureaucracy remains tethered to those it governs."[10]

The APA also requires that agencies acknowledge and account for the effects of one rulemaking on "contemporaneous and closely related rulemakings."[11] In other words, federal courts have explicitly required that an agency's "right hand take account of what its left hand is doing"[12] and have repeatedly held that an agency's failure to do so is arbitrary and capricious and invalidates the rulemaking.[13] Failing to consider the interactions and aggregate impact of interrelated proposed rules potentially subjects the public to conflicting or duplicative legal requirements and unnecessary compliance costs and contributes to an inefficient regulatory structure.

Courts have also held that the APA requires that any changes that a final rule makes to a proposed rule must be a "logical outgrowth" of the original proposal.[14] This principle is intended to

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[6] 5 U.S.C. § 553 (2023).
[7] *Id.* § 552(a)(1)(D).
[8] *Id.* § 706(2).
[9] U.S. DEPARTMENT OF JUSTICE, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 5 (1947).
[10] *Riverbed Farms, Inc. v Madigan*, 958 F.2d 1479, 1483-1484 (9th Cir. 1992).
[11] *Portland Cement Ass'n v. EPA*, 665 F.3d 177, 187 (D.C. Cir. 2011).
[12] *Id.* at 187.
[13] *Id.*; *see also*, *Off. of Commc'n of the United Church of Christ v. FCC*, 707 F.2d 1413 (D.C. Cir. 1983).
[14] *South Terminal Corp. v. EPA*, 504 F.2d 646, 659 (1st Cir. 1974).

recognize the need for agencies to adjust proposals to respond to public comments without repeating the entire notice-and-comment process, which would be inefficient, while ensuring that a final rule does not depart so widely from the proposal so as to deprive the public of a meaningful opportunity to comment on the rule.[15]

Economic Analysis

Under the National Securities Markets Improvement Act of 1996, Congress amended federal securities law requiring that "[w]henever . . . the [SEC] is engaged in rulemaking . . . the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[16] The U.S. Court of Appeals for the District of Columbia Circuit (the "D.C. Circuit") and Fifth Circuit have held that the statutory language imposes an obligation on the SEC to weigh the costs and benefits of proposed regulation.[17]

In 2012, the SEC promulgated guidelines for its economic analyses (the "Current Guidance") establishing "high-quality economic analysis [as] an essential part of SEC rulemaking."[18] The Current Guidance recommends that economic analysis: clearly identify the justification for the proposed rule, including any market failures; define the baseline against which to measure the proposed rule's economic impact; identify and discuss reasonable alternatives to the proposed rule; and quantify the benefits and costs of the rule to the extent feasible, including addressing any data provided by commenters that is contrary to the SEC's assessment.[19]

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[15] Henry L. Lifton, *Defining Fair Notice: Logical Outgrowth Doctrine Applied to the Waters of the United States* 92 NOTRE DAME L. REV. 943 (2016), https://scholarship.law.nd.edu/cgi/viewcontent.cgi?article=4697&context=ndlr.
[16] 15 U.S.C. § 77b(b), 78c(f), 80a-2(c).
[17] *See, e.g.*, *Chamber of Commerce v. SEC*, 85 F.4th 760, 779 (5th Cir. 2023); *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005).
[18] Division of Risk, Strategy, and Financial Innovation & Office of the General Counsel, SEC, *Memorandum Re: Current Guidance on Economic Analysis in SEC Rulemakings*(Mar. 16, 2012), https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.
[19] *Id.* at 5-15.

3. Shortcomings with the SEC's Regulatory Process and Economic Analyses

Recent SEC rulemakings and associated economic analyses have unfortunately often failed to adhere to the legal standards and policies described above.

Insufficient comment periods

The comment periods for several recent SEC rulemakings have failed to reflect the proposals' significance, complexity, and interconnectedness. This has made it difficult if not impossible for commenters to fully analyze and respond to the proposals.

Courts have held that 30 days is the bare minimum comment period for an agency rulemaking proposal under the APA.[20] But the norms that have traditionally guided agency rulemakings provide that comment periods should typically be significantly longer than 30 days and reflect the complexity of the proposal. For example, the executive order that prescribes general principles for agency rulemaking indicates that comment periods should normally be at least 60 days.[21] The Office of the Federal Register's Guide to the Rulemaking Process, which describes the principles that govern rulemaking by federal agencies, such as the SEC, suggests complex proposals should have comment periods of 180 days or more.[22]

By contrast, the average comment period for the rule proposals on the SEC's docket as of November 1, 2023, was just 47 days.[23] At least seven of these proposals had 30-day comment periods.[24] And while certain proposals purported to provide 60 days for comment, the timeframe

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[20] *Nat'l Lifeline Ass'n v. FCC*, 921 F.3d 1102, 1117 (D.C. Cir. 2019).
[21] Executive Order 12866 of Sept. 30, 1993, Fed. Reg. Vol. 58 No. 190 (Oct. 4, 1993), https://www.archives.gov/files/federal-register/executive-orders/pdf/12866.pdf.
[22] OFFICE OF THE FEDERAL REGISTER, *A Guide to the Rulemaking Process*, https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.
[23] Written Testimony of Kenneth E. Bentsen, Jr. President and CEO of SIFMA Before the U.S. House of Representatives Financial Services Committee Subcommittee on Capital Markets Hearing Entitled: "Examining the SEC's Agenda: Unintended Consequences for U.S. Capital Markets and Investors (Nov. 2., 2023), https://docs.house.gov/meetings/BA/BA16/20231102/116527/HHRG-118-BA16-Wstate-BentsenK-20231102.pdf.
[24] JENNIFER J. SCHLUP & NICHOLAS ANTHONY, CATO INSTITUTE, THE SEC SHORT-CHANGES PUBLIC COMMENT

was formulated so that the comment period would potentially run only 30 days following the proposal's official publication in the Federal Register.[25] Comment periods of 30 to 60 days should normally only accompany rulemakings of minimal volume and complexity. But the opposite is true: An estimate by SIFMA found that a mere subset of the rulemaking proposals and requests for information issued by the SEC within a 12-month period constituted 3,570 pages and included 2,260 questions and requests for data.[26] A CCMR analysis of SEC rulemakings during Chair Gensler's tenure illustrates the complex and unpredictable interconnections between these proposals.[27]

Furthermore, the SEC under Chair Gensler has, relative to prior periods, undertaken minimal public engagement, such as via public roundtables, before publishing its proposed rules. As a result, recent SEC proposals generally do not reflect feedback from a broad range of affected parties.

The disproportionality between the SEC's unprecedented rulemaking agenda and the minimal comment periods that it has provided, and its lack of public engagement, suggest that the SEC may be seeking to speed the finalization and effectiveness of its rulemaking agenda to avoid the possibility of its rules being overturned by a new Administration or under the Congressional Review Act. That statute empowers Congress and the President to overturn agency rules by joint resolution within 60 days of the rule's finalization and receipt by Congress.[28] Thus, if Congress

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(2022), https://www.cato.org/blog/sec-short-changes-public-comment.

[25] *See, e.g.*, SEC, *SEC Proposes to Enhance Private Fund Investor Protection,* Press Release (Feb. 9, 2022), https://www.sec.gov/news/press-release/2022-19.

[26] BPI, SIFMA et al., Letter to Chair Gensler, "Importance of Appropriate Length of Comment Periods" 4 (Apr. 5, 2022), https://fsforum.com/a/media/importance-of-appropriate-length-of-comment-periods.pdf.

[27] CCMR, *Regulatory Incidence of SEC Proposed & Final Rulemakings (Gensler Chairmanship, April 17, 2021 to August 15, 2023)* (Aug. 31, 2023), https://capmktsreg.org/wp-content/uploads/2023/08/CCMR-Statement-on-SEC-Agenda-Mapping-08.31.2023.pdf.

[28] CONGRESSIONAL RESEARCH SERVICE, THE CONGRESSIONAL REVIEW ACT (CRA): A BRIEF OVERVIEW (updated Feb. 27, 2023), https://crsreports.congress.gov/product/pdf/IF/IF10023.

and the Presidency were to become Republican in the next election then the new Congress and President could overturn regulations finalized within 60 days of the new Congress through the Congressional Review Act. The speed of SEC rulemaking and effectiveness date may be designed to preclude this possibility.

Failing to consider interrelated proposals.

The SEC has also on several recent occasions issued interrelated rule proposals but failed to consider the aggregate impact or interaction between those proposals. This has resulted in overlapping and conflicting regulations and overall incoherencies in the SEC's policymaking process. As one prominent example, the SEC recently finalized its short selling disclosure rule,[29] which delays the public release of short selling data by one month and aggregates the data so as to avoid quickly disclosing an individual market participant's short positions, because doing so would discourage short selling activity that is beneficial for capital markets.[30] However, the SEC's securities lending disclosure rule, which was finalized on the same day, inexplicably requires daily disclosure of transaction-level information for the securities loans that are used to facilitate short sales.[31] The daily disclosure of the securities loans underlying the short sales is the equivalent to disclosing the short sale itself, therefore the SEC's securities lending rule would publicly disclose the very short selling positions that the SEC was seeking to avoid disclosing in its short selling

[29] SEC, *Short Position and Short Activity Reporting by Institutional Investment Managers*, Exchange Act Release No. 34-98738, 88 Fed. Reg. 75,100, 75,132-33 (Nov. 1, 2023).
[30] *Id.* at 75,126.
[31] SEC, *Reporting of Securities Loans*, Exchange Act Release No. 34-98737, 88 Fed. Reg. 75,644, 75,741-42 (Nov. 3, 2023).

disclosure rule.[32] The SEC's securities lending rule is currently being legally challenged in the Fifth Circuit for this and other shortcomings.[33]

Ignoring the logical outgrowth principle

Recent SEC rulemakings have also departed significantly from the proposed versions without reopening the comment process. This has deprived the public of a meaningful opportunity to comment on the proposal and conflicts with the logical outgrowth doctrine outlined above. The SEC's securities lending rule again provides an instructive example. The final version of the SEC's securities lending rule introduced a 20-day delay in disclosure of the loan size for a securities loan that was not included in the proposed rule.[34] In the final release, the SEC claimed that the delay would avoid publicly exposing the short selling positions that were the basis of the securities loans.[35] But as CCMR explained in its amicus brief to the Fifth Circuit in the lawsuit challenging the securities lending rule, the SEC's rationale is invalid, and the contemplated delay will not provide the claimed benefits.[36] The public never had the opportunity to make these comments during the rule proposal stage, because the delay provision was not contemplated in the proposed rule, and the SEC did not reopen the comment process after making this change to the proposal.

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[32] Brief for *Amicus Curiae* Committee on Capital Markets Regulation in Support of Petitioners at 14, *Nat'l Ass'n of Private Fund Managers v. SEC*, No. 23-60626 (5th Cir. Mar. 12, 2024), ECF No. 21, https://capmktsreg.org/wp-content/uploads/2024/03/CCMR-Amicus-Brief-%E2%80%93-SEC-Securities-Lending-Rule-Litigation.pdf.
[33] MANAGED FUNDS ASSOCIATION, *NAPFM, MFA, and AIMA Challenge SEC Securities Lending and Short Position Reporting Rules* (Dec. 12, 2023), https://www.mfaalts.org/press-releases/napfm-mfa-and-aima-challenge-sec-securities-lending-and-short-position-reporting-rules/.
[34] SEC, *Reporting of Securities Loans*, Exchange Act Release No. 34-98737, 88 Fed. Reg. 75,644, 75,665 (Nov. 3, 2023).
[35] *Id.* ("Such concerns are largely addressed by requiring that an RNSA delay public disclosure of the loan amount by 20 business days.")
[36] Brief for *Amicus Curiae* Committee on Capital Markets Regulation in Support of Petitioners, *supra* note 32, at 23-24.

This failure to abide by the logical outgrowth principle is another basis on which the securities lending rule is being legally challenged.[37]

Economic Analysis

Although recent economic analyses by the SEC have been lengthy and purported to examine many issues, CCMR has found that these economic analyses have often been based on material factual inaccuracies, riddled with conclusory assertions, failed to contend with fundamental issues, and ignored significant amounts of empirical research that reveal the potential for significant costs or cast doubt on purported benefits of a proposal.[38] CCMR has raised concerns that this may reflect a trend of seeking to demonstrate a technical or superficial compliance with the APA with the aim of achieving a specific regulatory agenda rather than treating the economic analysis as an opportunity for an objective and self-critical analysis of the costs and benefits of a rule.[39]

Inadequate economic analysis exposes rulemakings to legal challenges thereby creating costly market uncertainty. In the recent case of *Chamber of Commerce v. SEC*, the Fifth Circuit held that when the SEC asserts that a rulemaking will create benefits by addressing a purported problem in the market, the SEC's economic analysis must demonstrate with evidence that the problem actually exists.[40] In this case, the SEC asserted that its share repurchase rule would address the problem of managers of public corporations opportunistically timing share buybacks to financially benefit themselves. But the court found that the SEC failed to offer any evidence that improperly timed

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[37] *See* Opening Brief for Petitioners at 50-53, *Nat'l Ass'n of Private Fund Managers v. SEC*, No. 23-60626 (5th Cir. Mar. 5, 2024), *available at* https://www.aima.org/asset/D2DC3124-7E14-4420-838AD9E47AEE99BB/..
[38] *See, e.g.*, COMMITTEE ON CAPITAL MARKETS REGULATION ["CCMR"], *U.S. Financial Regulatory Agencies and the Rule of Law*, at 3-5 (Oct. 18, 2022), https://capmktsreg.org/wp-content/uploads/2022/11/CCMR-Financial-Regulatory-Agencies-and-the-Rule-of-Law-10.18.22.pdf.
[39] *Id.* at 5.
[40] *Chamber of Com. v. SEC*, No. 23-60255, 2023 WL 7147273 (5th Cir. Oct. 31, 2023).

buybacks actually occurred and were a "genuine problem" in the market.[41] The court also found that the SEC claimed that it was impossible to quantify the rule's effects but then ignored evidence that commenters provided demonstrating that such a quantification was in fact possible.[42] The court found that this was "arbitrary and capricious" and was therefore another fatal flaw in the economic analysis and invalidated the SEC's rule.[43]

The economic analyses for several recent SEC rulemakings have suffered from these same issues. Two particularly significant examples are the economic analyses for (1) the private funds rule and (2) the four related equity market structure proposals. The inadequacy of the SEC's economic analysis for its private funds rule is one key basis on which that rule is currently being legally challenged in the Fifth Circuit.[44]

Private Funds

In its private funds rule, the SEC asserted that there is a lack of competition in the market for private investment fund advisers and that its rule will benefit the market by enhancing competition.[45] However, the SEC's economic analysis failed to demonstrate that there is any such problem with competition in the private funds market. First, as addressed by CCMR's comment letters and amicus brief in the Fifth Circuit case, the SEC's economic analysis ignored the fundamental metrics that both government authorities and academic experts use to measure

[41] *Id.* at *11.
[42] *Id.* at *9.
[43] *Id.*
[44] AMERICAN INVESTMENT COUNCIL, *AIC Joins Lawsuit Against SEC for Unlawful Private Funds Advisers Rule that Harms Small Businesses, Investors, and the Economy* (Sept. 1, 2023), https://www.investmentcouncil.org/aic-joins-lawsuit-against-sec-for-unlawful-private-fund-advisers-rule-that-harms-small-businessesinvestors-and-the-economy/.
[45] SEC, *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance*, Advisers Act Release No. IA-6383, 88 FED. REG. 63,206, 63,360 (Sept. 14, 2023).

whether a market is competitive, including price competition and industry concentration.[46] Moreover, the evidence on private fund fees, net-of-fee performance and industry concentration in the private funds market decisively demonstrates that the private-funds market is highly competitive.[47]

Furthermore, the SEC claimed in its economic analysis of the private funds rule that it "lacks the information necessary" to quantify the costs and benefits of the rule.[48] However, the economic analysis ignored data from the SEC's very own Form Private Fund filings, which contains detailed data on fees and net-of-fee returns for thousands of private funds going back to 2013, which the SEC could have used to determine whether there is an actual problem with competition in the private funds market.[49] The SEC also largely ignored the voluminous evidence presented by commenters, including over 200 empirical studies, indicating that the SEC's basic characterization of the private funds market as uncompetitive is inaccurate.[50] Because of these and other flaws with the private funds rule, the Fifth Circuit is currently considering whether to invalidate it.

Equity Market Structure

The economic analyses for the SEC's four interrelated equity market structure ("EMS") rules suffer from the same critical flaws. Specifically, the SEC asserted that the current U.S. equity market structure is uncompetitive and that the off-exchange segment of the U.S. equity market is

[46] CCMR, *Committee Files Amicus Brief Challenging the SEC's Private Funds Rule*, 12 (Nov. 2023) https://capmktsreg.org/wp-content/uploads/2023/11/CCMR-Amicus-Brief-Private-Funds-Litigation.pdf.
[47] *Id.* at 14.
[48] SEC, *supra* note 45 at 63,293.
[49] CCMR, *supra* note 46 at 22-23.
[50] *Id.* at 25.

too concentrated.[51] The SEC's economic analyses asserted that the EMS proposals will benefit the market by increasing competition and reducing concentration.[52]

However, the economic analyses failed to substantiate any such problem with the U.S. equity market structure. In fact, the SEC ignored empirical evidence showing the opposite. CCMR's comment letter demonstrated that the U.S. equity market structure provides investors with the lowest transaction costs out of all jurisdictions in the world, and that these costs have been declining over time.[53] Indeed, retail investors now benefit from commission-free trading at the major brokerages.[54] With regard to concentration, CCMR presented an analysis showing that concentration in the market for off-exchange trading, is substantially lower than in the market for on-exchange trading and below the threshold that the FTC and DOJ use to identify concentrated marketplaces for purposes of antitrust analysis, thus directly undercutting the SEC's rationale for the rule.[55] In addition, the SEC based its economic analysis on non-public Consolidated Audit Trail ("CAT") data but did not publicize this data – which could have been anonymized to protect confidentiality – in connection with its proposal, even after multiple commenters identified it as crucial to assessing the economic analyses.[56] As such, commenters could not assess the reliability

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[51] *See, e.g.*, *See, e.g.*, SEC, *Order Competition Rule*, Exchange Act Release No. 34-96495, 88 Fed. Reg. 128, 190 (Jan. 3, 2023); Chair Gary Gensler, *Statement on Proposal to Enhance Order Competition*, SEC (Dec. 14, 2022), https://www.sec.gov/news/statement/gensler-order-competition-20221214.

[52] SEC, *Regulation Best Execution*, Exchange Act Release No. 34-96496, 88 Fed. Reg. 5,440, 5,529 (Jan. 27, 2023); SEC, *Disclosure of Order Execution Information*, Exchange Act Release No. 34-96493, 88 Fed. Reg. 3,786, 3,862 (Jan. 20, 2023); SEC, *Order Competition Rule*, Exchange Act Release No. 34-96495, 88 Fed. Reg. 128, 178 (Jan. 3, 2023); SEC, *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*, Exchange Act Release No. 34-96494, 87 Fed. Reg. 80.266, 80,337, 80,349 n.717 (Dec. 29, 2022).

[53] CCMR, Comment Letter Re.: File Number S7-29-22 – *Disclosure of Order Execution Information*; File Number S7-30-22 – *Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders*; File Number S7-31-22 – *Order Competition Rule*; File Number S7-32-22 - *Regulation Best Execution*, at 5-6 (Mar. 31, 2023), https://capmktsreg.org/wp-content/uploads/2023/04/CCMR-Comment-Letter-on-EMS-Proposals-03.31.23.pdf.

[54] *Id.* at 45.

[55] *Id.* at 8-9.

[56] *See, e.g.*, Virtu Financial, Comment Letter Re: Order Competition Rule, Release No. 34-96495; File No. S7-31-22 (Mar. 30, 2023), https://virtu-www.s3.us-east-

of the data or the validity of the conclusions that the SEC drew from that data. The economic analyses for the EMS proposals therefore demonstrate the same fatal flaws as the share buyback rule.

4. Enhancing the SEC's Regulatory Process – Economic Analyses and Other Procedural Reforms

A well-reasoned and evidence-based economic analysis is both a legal requirement and essential for SEC rulemakings to achieve their policy goals. I therefore support legislative reforms to clarify and enhance the criteria for the SEC's economic analyses. Various reforms of this type have been proposed in the SEC Regulatory Accountability Act and other bills. Although some of these reforms reflect criteria that the courts have already articulated based on existing statute, codifying these principles will reduce the likelihood of litigation, increase certainty for market participants and the SEC, and streamline the rulemaking process.

For example, as part of its economic analyses, the SEC should be required to:

- *Clearly identify and substantiate that a market failure exists and that a proposed rule will address the failure:* For each of its rulemakings, the SEC should be required to show in its economic analysis how the rule would address an identifiable problem in the market and substantiate with evidence that the problem actually exists.[57] Several recent SEC rulemakings have failed to do so.[58]

1.amazonaws.com/uploads/documents/Virtu%20Financial%20Inc.%20Re%20Order%20Competition%20Rule%20Release%20No.%2034-96495_File%20No.%20S7-31-22.pdf.

[57] *See* SEC Regulatory Accountability Act, H.R. 9603, 117th Cong. § 2 (2022) (requiring the SEC to "clearly identify the nature and source of the problem that the proposed regulation is designed to address, as well as assess the significance of that problem, to enable assessment of whether any new regulation is warranted").

[58] *See, supra* pp.13-15 (discussing Private Funds and Equity Market Structure rules).

- *Make a reasonable determination that the benefits of a proposed rule outweigh its costs:* A basic principle of sound policymaking is that the benefits of a rule should outweigh its costs. The law requires that the SEC seek to identify the positive and negative economic effects of its proposals, but it should be clear that the results of that cost-benefit analysis must be positive for a rulemaking proposal to become law.[59]
- *Quantify the costs and benefits of a proposed rule to the extent reasonably possible:* As detailed above, several recent economic analyses have failed to use readily available data to quantify the economic effects of a rule despite the SEC's claims that such a quantification is not possible.[60] The law should be clear that the SEC must quantify the economic effects of its rules where such a quantification is reasonably possible, and that the SEC must take account of relevant data supplied by commenters.[61] Both the U.K.[62] and the E.U.[63] have similar requirements.
- *Consider the effects of other related proposed rules:* In several of its recent economic analyses, the SEC has omitted consideration of the effects of its related and contemporaneous proposals.[64] Economic analyses that ignore the consequences stemming

[59] H.R. 9603 § 2 (requiring the SEC to "…adopt a regulation only on a reasoned determination that the benefits of the intended regulation justify the costs of the regulation").
[60] *Id.*
[61] *See* Independent Agency Regulatory Analysis Act of 2017, S. 1448, 115th Cong. § 3(b)(1)&(2) (2017) (specifying that the President may require an independent regulatory agency to publish a quantification of costs and benefits, to the extent feasible, for economically significant rules); see also id. § 3(a)(7) (specifying that the President may require an independent regulatory agency to "base its rulemaking decisions on the best reasonably obtainable scientific, technical, economic, and other information…").
[62] UK Public General Acts, *Financial Services and Markets Act 2000*, § 138I (Jan. 30, 2024), https://www.legislation.gov.uk/ukpga/2000/8/section/138I.
[63] European Commission, *Better Regulation: Joining forces to make better laws*, Communication from the Commission to the European Parliament, the Council, the European and Social Committee and the Committee of the Regions (2021), https://commission.europa.eu/document/download/199176cf-6c4e-48ad-a9f7-9c1b31bbbd09_en?filename=better_regulation_joining_forces_to_make_better_laws_en.pdf.
[64] *See, e.g.*, SEC, *Reporting of Securities Loans*, Exchange Act Release No. 34-98737, 88 Fed. Reg. 75,644 (Nov. 3, 2023); SEC, *Regulation Best Execution*, Exchange Act Release No. 34-96496, 88 Fed. Reg. 5,440 (Jan. 27, 2023); SEC, *Disclosure of Order Execution Information*, Exchange Act Release No. 34-96493, 88 Fed. Reg. 3,786 (Jan. 20, 2023); SEC, *Order Competition Rule*, Exchange Act Release No. 34-96495, 88 Fed. Reg. 128 (Jan. 3, 2023); SEC,

from the interaction and aggregate impact of interrelated rules are not grounded in reality and are therefore ineffective. Although these omissions may violate the SEC's existing obligation to perform an adequate economic analysis, this basic principle of requiring sound economic analysis should be strengthened in new legislation.

In addition to reforms that improve the quality of the SEC's economic analyses, I also support legislation clarifying and supplementing other aspects of the SEC's rulemaking procedures. For example:

- *Adding a general look-back requirement*: The SEC should be required to periodically review its past rulemakings and to identify rules that have become obsolete, redundant, or ineffective.[65] While the Regulatory Flexibility Act includes a version of this requirement, it is limited to rules that affect a large number of small businesses.[66] Generalizing this requirement to all SEC rules would better ensure that outdated rulemakings do not unduly curtail competition or innovation. Financial regulation in other jurisdictions implement similar principles. For example, the EU's financial regulatory framework requires that regulators periodically review existing rules to assess their continued effectiveness and, if necessary, recommend that they be amended or repealed.[67]
- *Increasing the minimum comment period*: SEC rule proposals are increasingly complex, lengthy, and wide-ranging. They also commonly contain numerous questions and requests for data and analysis from market participants. It is important that affected parties have

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Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders, Exchange Act Release No. 34-96494, 87 Fed. Reg. 80.266 (Dec. 29, 2022).

[65] *See* SEC Regulatory Accountability Act, H.R. 9603, 117th Cong. § 2 (2022) (requiring periodic assessment of "major rules") (citation omitted).

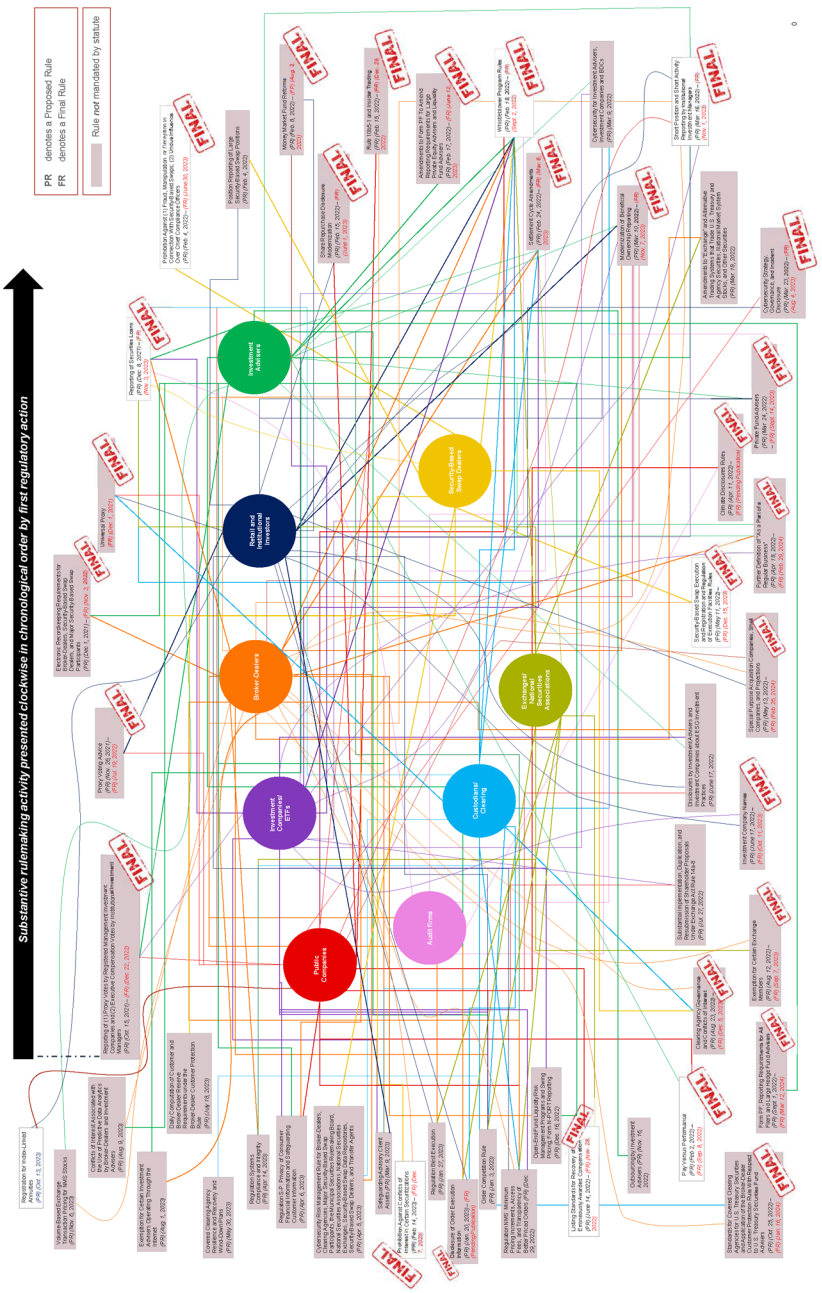
[66] 5 U.S.C. §§ 601-612.

[67] *See, e.g.*, MiFID II, Art. 90.

sufficient time to analyze and respond to these proposals, including the SEC's questions and requests for data. Many of the SEC's recent comment periods are clearly insufficient in this regard. The SEC should be subject to a statutory minimum comment period of 60 days, with an extended minimum of 180 days for complex or economically significant rulemakings, consistent with the Office of the Federal Register's Guide to the Rulemaking Process.

- *Requiring the proposal of related rulemakings together*: The SEC should be prohibited from simultaneously proposing related and overlapping rulemakings separately to avoid potential conflicts between rules and to ensure a coherent approach to policymaking. This will also facilitate economic analyses that account for the interaction and aggregate impact of interrelated rules.
- *Requiring re-proposals after major changes from an initial proposal*: The courts have held that current statutes require the SEC to repropose a rule when the final rule is not a "logical outgrowth" of the original proposal. This is necessary to ensure the public has the ability to comment on major SEC actions. However, the application of this standard can be unclear and become the subject of litigation. Legislation should provide for a clearer standard.

Appendix 1: Regulatory Incidence of SEC Proposed & Final Rulemakings (Gensler Chairmanship, Apr. 17, 2021 – Mar. 15, 2024)



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Testimony
Before the U.S. House Committee on Financial Services
Subcommittee on Capital Markets
Hearing on "SEC Overreach: Examining the Need for Reform"

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March 20, 2024

Chair Wagner, Ranking Member Sherman, and distinguished members of Subcommittee on Capital Markets, my name is Jennifer Schulp, and I am the Director of Financial Regulation Studies at the Cato Institute's Center for Monetary and Financial Alternatives. The views I express in this testimony are my own and should not be construed as representing any official position of The Cato Institute.

I thank you for the opportunity to take part in today's hearing entitled, "SEC Overreach: Examining the Need for Reform."

It is often said that the U.S. financial markets are the largest, deepest and most liquid in the world. Regulatory decision-making by the Securities and Exchange Commission (SEC or Commission)—whether in the form of promulgating rules, providing guidance, or bringing enforcement actions—directly impacts those U.S. securities markets. The Commission's reach is vast. It oversees the annual trading of approximately $118 trillion in U.S. equities markets, $2.8 trillion in exchange-traded options, and $237 trillion in fixed income markets. Disclosures and financial statements of more than 5,000 exchange-listed public companies with an aggregate market capitalization of $51 trillion are subject to SEC regulation and review. The SEC regulates the activities of more than 29,000 registered entities (including investment advisers, broker-dealers and investment companies), who employ at least one million individuals. And the SEC oversees twenty-four national securities exchanges, nine credit rating agencies, seven registered clearing agencies, the Public Company Accounting Oversight Board, and the Financial Industry Regulatory Authority, among other non-governmental organizations.[1]

[1] *See* Securities and Exchange Commission, *Strategic Plan Fiscal Years 2022-2026*, at 4, https://www.sec.gov/files/sec_strategic_plan_fy22-fy26.pdf (describing the "broad and diverse set of responsibilities" the SEC is tasked with by the federal securities laws).

The impact of the SEC's regulation is felt by everyday Americans. As of 2022, 58% of American families held stock, an all-time high.[2] And a wider range of Americans—younger, less wealthy, and more diverse—have been entering the markets in recent years.[3] While the stock market and the economy are not one and the same, the ability of individuals and entities to raise capital to grow and support their businesses—and the ability of individuals and entities to invest in others' businesses—is the backbone of American economic growth. Importantly, stability and predictability are important to the functioning of these capital markets.

This is all to say that the SEC is important. The regulation that it undertakes impacts entrepreneurs and investors and employers and employees, both at home and abroad.

The SEC describes its three-part mission as protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation. This is a complicated mission, and it is one that cannot be—and is not intended to be—carried out without accountability to elected officials and input by members of the public, especially those who are impacted by the Commission's regulatory decisions. Such accountability and corresponding transparency results in better public policy decisions and stands as a bulwark against the arbitrary or capricious actions of a regulator unbound to the people and their representatives. As SEC Commissioner Mark Uyeda recently opined: "[w]hen a regulator can, without practical limitation, promulgate, interpret, and enforce rules and guidance, including retroactively, the temptation to be arbitrary in the exercise of administrative power and enforcement can be great."[4]

The SEC, however, falls short of this ideal. As described below, the Commission would benefit from reforms aimed at (i) increasing the accountability and transparency of the agency to lawmakers and the public, (ii) ensuring adequate input and analysis to improve agency rulemaking, and (iii) holding the agency to high standards in the exercise of its functions.

This discussion is not meant to be exhaustive. Undoubtedly, there are structural or procedural reforms that the SEC could undertake to increase its effectiveness or decrease its costs. And there are also reforms that I would recommend to the agency's prioritization of resources, in addition to changes to substantive law or regulation, to better meet the Commission's mission and support the choices of individuals using the securities markets. Instead, this discussion focuses on highlighting specific areas for reform that will improve the

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[2] Board of Governors of the Federal Reserve System, *Survey of Consumer Finances, 1989-2022*, Stock Holdings by All Families, November 2, 2023, https://tinyurl.com/7dxzz94x; Hannah Miao, "More Americans Than Ever Own Stocks," *Wall Street Journal*, December 18, 2023, https://www.wsj.com/finance/stocks/stocks-americans-own-most-ever-9f6fd963.

[3] *See* Jennifer J. Schulp and Jack Solowey, "Technology Is Helping Open Markets to New Investors. So Why Is the SEC Hostile to It?," *Barron's*, November 6, 2023, https://www.cato.org/commentary/technology-helping-open-markets-new-investors-so-why-sec-hostile-it (describing increasing investor participation in U.S. markets); Jennifer J. Schulp, "GameStop and the Rise of Retail Trading," 41 *Cato Journal* 511 (Fall 2021), https://www.cato.org/cato-journal/fall-2021/gamestop-rise-retail-trading.

[4] Mark T. Uyeda, "Remarks to the Council of Institutional Investors – Dangers of the Unbounded Administrative State," Speech, March 5, 2024, https://www.sec.gov/news/speech/uyeda-remarks-cii-030524.

Commission's accountability, responsiveness, and competence, regardless of the substance of the policy agenda that the SEC's Chairman pursues.

Increasing Accountability and Transparency of the SEC to Lawmakers and the Public

The SEC may be an "independent" agency, but that distinction does not grant it special privileges with respect to oversight by Congress or an exception to the basic constitutional protections that ensure governmental accountability to the people.

Congress's ability to conduct oversight over the Executive Branch is inherent in its legislative powers enumerated in the U.S. Constitution. Such oversight is a critical mechanism to ensure transparency, accountability, and the proper functioning of the federal government within a system of checks and balances.

Regularizing certain aspects of Congressional oversight of the SEC, including by requiring periodic testimony of the SEC Chairman and Commissioners, has the potential to increase the agency's accountability and transparency. As it currently stands, many SEC offices are required to submit periodic reporting to Congress, including the Office of the Advocate for Small Business Capital Formation, the Office of the Investor Advocate, and the Inspector General.[5] The SEC is also required to report to Congress on a variety of subject-matter specific issues, including the public and internal use of machine-readable data for corporate disclosures and the modernization of the SEC's website.[6]

Yet, there is no requirement that either the SEC Chairman or any of the other Commissioners appear to provide Congressional testimony on a regular basis. Such in-person testimony can be a valuable supplement to written reporting, but it also serves its own purpose in facilitating direct oversight by Members of Congress. These interactions would allow SEC officials to share information about the agency's policy priorities and operations and allow members of Congress to share their views about the same. This direct conduit to question the Commission is even more important where the Commission, or its Chairman, is not responsive to written requests from Congress in its oversight capacity.[7]

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[5] *See* 15 U.S.C. § 78d(j)(6); 15 U.S.C. §78d(g)(6); 5 U.S.C. § 405 and 31 U.S.C. § 3516.

[6] *See* Financial Data Transparency Act of 2022, S.4295, 117th Cong. § 205(b) (2022); 21st Century Integrated Digital Experience Act of 2018, P.L. 115-336, § 3(d), 44 U.S.C. § 3501 *et seq.* (2018). *See also* Securities and Exchange Commission, "Reports and Publications," search limited to "Annual Reports," https://www.sec.gov/reports?ald=edit-field-article-sub-type-secart-value&year=All&field_article_sub_type_secart_value=Reports+and+Publications-AnnualReports&tid=All (listing annual reports made by the SEC, many of which are required by to be made to Congress).

[7] *See, e.g.,* Oversight of the Securities and Exchange Commission: Hearing by Oversight and Investigations Subcommittee for the House Committee on Financial Services, 118th Cong. (2023) (Bill Huizenga questions to Gary Gensler), available at https://huizenga.house.gov/news/documentsingle.aspx?DocumentID=401607 (referring to Letter from Patrick McHenry, Tim Scott, and Bill Huizenga to Gary Gensler, February 22, 2023), https://huizenga.house.gov/uploadedfiles/2023-02-22_hfsc_sbc_to_gensler_re_climate_disclosure_rule_-_final.pdf; Letter from James Comer to Gary Gensler, October 12, 2023, https://oversight.house.gov/wp-

Such a requirement may not be necessary where there is a strong custom in favor of regularly calling the SEC Chairman and Commissioners to appear to provide testimony to Congress. However, where regular periodic testimony is not customary—for whatever reason—a statutory mandate can serve to regularize, and depoliticize, the fact of Congressional oversight of the Commission.

Requiring an agency head to appear for regular testimony before Congress is hardly unheard of. In the context of financial regulation, the most obvious example is the bi-annual testimony of the Chairman of the Federal Reserve Board of Governors required by the Full Employment and Balanced Growth Act of 1978 (also known as the Humprey-Hawkins Act).[8]

Due to the Commission's design as a five-member body, required by law to have no more than three Commissioners from the same political party, testimony that is not solely focused on the viewpoint of the Chairman may be useful in providing more robust oversight opportunities. The Chairman's views are most often associated with the priorities and performance of the agency, even though he does not speak for the whole Commission. For example, the Chairman sets forth a strategic plan for the agency, but, as the plan discloses, it "sets forth the Chair's vision for the next four years" and "may not necessarily represent the views of all of the Commissioners."[9] Hearing the viewpoints of the other Commissioners—particularly the minority Commissioners—can assist in ensuring that the Commission retains some of level of political balance, or political moderation, that was intended by requiring the Commission to be bipartisan.

In addition to the direct oversight opportunities created by periodic Congressional testimony by SEC Commissioners, there are several areas of additional institutional reform that would create conditions to increase the SEC's accountability and transparency. Two such reforms relate to the SEC's enforcement authority, which the agency exercises pursuant to its own practices that undermine the ability of both Congress and the public to evaluate the agency's performance.

First, the Commission's own policies prohibit those who settle enforcement actions with the Commission from criticizing the basis for the factual allegations made by the Commission in the settlement document.[10] This lifetime gag order, which SEC Commissioner Hester Peirce describes as "unnecessary" and "undermin[ing] regulatory integrity,"[11] is not just

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content/uploads/2023/10/Followup-to-SEC-re-doc-productions.pdf ("your agency is delaying, misleading, and blocking access to the records the [House Committee on Oversight and Accountability]").

[8] Full Employment and Balanced Growth Act of 1978, 15 U.S.C. § 3101 *et seq*.

[9] *See* Securities and Exchange Commission, *Strategic Plan Fiscal Years 2022-2026*, at 4, https://www.sec.gov/files/sec_strategic_plan_fy22-fy26.pdf.

[10] 17 C.F.R. § 202.5(e).

[11] Hester Peirce, "Unsettling Silence: Dissent from Denial of Request for Rulemaking to Amend 17 C.F.R. § 202.5(e)," Statement, January 30, 2024, https://www.sec.gov/news/statement/peirce-nand-013024.

a problem for the First Amendment rights of those who are settling with the SEC.[12] This practice of silencing critics also prohibits Congress and the public from holding the agency to account for enforcement settlements (which are, by far, the most likely result of an enforcement action brought by the Commission).

Second, the SEC's use of administrative law courts similarly raises issues with the agency's accountability. The ability of the SEC to bring actions in its own administrative courts, rather than in Article III judicial courts, has expanded over time.[13] A host of constitutional issues raised by the SEC's use of administrative courts is under consideration by the Supreme Court in *SEC v. Jarkesy*.[14] In addition, the Supreme Court has already permitted targets of agency administrative action to raise collateral constitutional issues in federal court, instead requiring a full administrative adjudication before constitutional claims can be effectively heard.[15] But setting aside the technicalities of the constitutional questions, the agency's use of administrative courts denies defendants—and the public more generally—the accountability provided by independent judicial courts. Requiring the SEC to prove its case under the same standards that apply in other civil enforcement actions brought by the government in judicial courts brings the same level of accountability and transparency to agency actions. That accountability is sorely lacking when the SEC can bring enforcement actions by its own rules that unfairly favor the agency.[16]

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[12] *See, e.g.,* Brief of the Competitive Enterprise Institute, Cato Institute, Institute for Justice, and Institute for Free Speech as Amici Curiae Supporting Petitioner, *Romeril v. SEC*, No. 21-1284 (Supreme Court) (April 22, 2022), https://www.cato.org/sites/cato.org/files/2022-04/ROMERIL-final.pdf.

[13] *See* Center for Capital Markets Competitiveness, "Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices," *U.S. Chamber of Commerce*, July 2015, at 11, https://www.centerforcapitalmarkets.com/wp-content/uploads/2015/07/021882_SEC_Reform_FIN1.pdf (describing history of SEC authority to bring actions in administrative proceedings).

[14] No. 22-859 (Supreme Court).

[15] *SEC v. Cochran*, 142 S. Ct. 2707 (2022). It's worth noting that while SEC administrative adjudications have been decreasing amid constitutional challenges to their usage beginning with *Lucia v. SEC*, 138 S. Ct. 2044 (2018), the Commission's most recent budget request sought to increase the staffing in its Office of Administrative Law Judges from 7 to 12. Securities and Exchange Commission, "Fiscal Year 2024 Congressional Budget Justification," at 47, https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf. The Commission provides no justification for this increase in staffing level, so it is difficult to say with any certainty to what degree it reflects an interest in increasing the use of administrative law judges for certain contest matters.

[16] *See* Brief of the Cato Institute As Amicus Curiae in Support of Respondents, *SEC v. Jarkesy*, No. 22-859 (Supreme Court), October 18, 2023, at 11-20, https://www.cato.org/sites/cato.org/files/2023-10/Legal-Brief-SEC-v-Jarkesy.pdf (describing the ways in which the SEC's administrative process unfairly favors the agency). The same questions about accountability apply to the SEC's oversight of non-governmental entities such as the Public Company Accounting Oversight Board and self-regulatory organizations such as the Financial Industry Regulatory Authority. Reforms to these processes—which touch on a myriad of complex constitutional questions—exceed the scope of my written testimony, but it is important to consider whether the exercise of governmental authority by non-governmental actors is appropriately accountable and transparent to elected officials.

Ensuring Adequate Input and Analysis to Improve SEC Rulemaking

As noted above, the rules that the SEC promulgates directly impact the economy, providing the rules by which entrepreneurs and investors exchange capital. Because rulemaking occurs outside of the legislative process—at the SEC and other administrative agencies—Congress provided the framework by which such rulemaking must occur in the Administrative Procedure Act (APA). Importantly, the APA, among other things, provides for public participation in the rulemaking process and sets forth the basic standards that a rule must meet to survive judicial review.

Although the SEC, as an independent agency, is not subject to certain Executive Orders regarding rulemaking, the agency is subject to the APA.[17] The Commission, however, has a mixed record, at best, when complying with the requirements and spirit of the Act.

Within the past couple of years, the SEC has been found to have acted "arbitrarily and capriciously" within the meaning of the APA (or otherwise exceeded its statutory authority) in its administrative actions on multiple occasions, including in *Chamber of Commerce v. SEC,*[18] *Institutional Shareholder Services Inc. v. SEC*,[19] and *Grayscale Investments, LLC v. SEC*.[20] Multiple recently finalized SEC rules are being challenged on the same grounds.[21] When adding these challenges to the SEC's long history of seeing rules overturned by courts (including in *Business Roundtable v. SEC*[22] and *Chamber of Commerce v. SEC*[23]), it makes sense to consider whether the SEC rulemaking process is in need of reform.

Moreover, the Commission has often strayed from the preferred method of rulemaking for creating agency policy, relying inappropriately on agency guidance and enforcement actions to create new regulation. Staff Accounting Bulletin 121[24]—which the U.S. Government Accountability Office found constituted a rule for the purposes of the Congressional Review Act because it meets the definition of a rule under the APA[25]—is a prime example of relying on informal agency guidance to issue "definitive interpretative guidance" for a "very specific, very limited number of public companies."[26] SAB 121 is far from the only example, however, of the

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[17] 5 U.S.C. § 551(1).
[18] 85 F.4th 760 (5th Cir. 2023) (share repurchase rule).
[19] Memorandum Opinion, Civil No. 19-cv-3275 (APM) (D.D.C. February 23, 2024) (proxy solicitation rule).
[20] 82 F.4th 1239 (D.C. Cir. 2023) (Bitcoin ETP denial order).
[21] Litigation has been filed on the SEC's climate risk disclosure rule, private fund adviser rule, short selling reporting rule, securities lending rule, dealer rule, and proxy-voting advice rule.
[22] 905 F.3d 1144 (D.C. Cir. 2011).
[23] 412 F.3d 133 (D.C. Cir. 2005).
[24] Securities and Exchange Commission, Staff Accounting Bulletin No. 121, April 11, 2022, https://www.sec.gov/oca/staff-accounting-bulletin-121.
[25] U.S. Government Accountability Office, "Securities and Exchange Commission—Applicability of the Congressional Review Act to Staff Accounting Bulletin No. 121," B-334540, October 31, 2023, https://www.gao.gov/products/b-334540.
[26] Hester M. Peirce, "Response to Staff Accounting Bulletin No. 121," Statement, March 31, 2022, https://www.sec.gov/news/statement/peirce-response-sab-121-033122.

SEC using interpretative guidance to have the broad force of a regulation, without having gone through the notice-and-comment process.[27]

Similarly, on the enforcement front, the SEC routinely touts its success in charging "first-of their kind" cases and bringing significant actions "to protect investors in new and emerging areas, including cases charging misconduct involving cyber issues and crypto securities."[28] While not all first-of-their-kind cases are inappropriate, the Commission should not champion leading with enforcement when addressing novel applications of existing rules. This has been a particular problem with respect to the SEC's treatment of digital assets,[29] but the problem is not limited to crypto.[30] And the problem is compounded by using the SEC's limited enforcement resources—which are already strained—to carry a much heavier load by creating policy, rather than simply enforcing existing laws and regulations.[31]

Both informal guidance and enforcement produce less certain and less clear rules for market participants and can result in unfair treatment of such market participants, undermining public trust in the agency. Just as importantly, pursuing these pathways rather than notice-and-comment rulemaking decreases the quality of the regulation by preventing public input about the policy being advanced. While not all agency guidance must go through formal rulemaking, the Commission must more rigorously evaluate whether informal agency action—through guidance or enforcement—is creating de facto rules. And if so, the Commission should subject such rules to formal notice-and-comment rulemaking.

Quality rulemaking under the APA relies on two key tenets: public input and robust agency analysis. The Commission's track record on both dimensions suggests that reform may be useful to improve the quality of the agency's rulemaking.

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[27] *See, e.g.,* Jennifer J. Schulp, "The SEC as 'Everything Regulator' Strikes Again," *Cato At Liberty*, February 2, 2024, https://www.cato.org/blog/sec-everything-regulator-strikes-again (commenting on interpretive guidance about the definition of an investment company issued along with SPAC rule proposal).

[28] Securities and Exchange Commission, "Fiscal Year 2024 Congressional Budget Justification," at 22, https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf.

[29] *See, e.g.,* Hester M. Peirce, "Outdated: Remarks before the Digital Assets at Duke Conference," Speech, January 20, 2023, https://www.sec.gov/news/speech/peirce-remarks-duke-conference-012023.

[30] *See, e.g.,* Peter Chan and A. Valerie Mirko, "Recommendations to the SEC to Modify its Procedural Framework to Prevent Regulation by Enforcement," *Financial Services Institute*, January 2024, at 9-11, https://tinyurl.com/3y5h7ud9 (describing what is meant by regulation by enforcement).

[31] Indeed, last year, 67 percent of enforcement staff "disagreed or strongly disagreed that the Enforcement Division's human capital resources were sufficient to handle the investigative load." The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2023, at 15, https://www.sec.gov/files/statement-secs-management-and-performance-challenges-october-2023.pdf. Timeliness of enforcement investigations remains an issue with the agency. Office of the Inspector General, "Enforcement Investigations: Measures of Timeliness Showed Some Improvement But Enforcement Can Better Communicate Capabilities for Expediting Investigations and Improve Internal Processes," *Securities and Exchange Commission*, February 15, 2023, https://www.sec.gov/files/enforcement-investigat-meas-timeliness-show-some-improvement-enforcement-can-better-comm.pdf.

Public Input Is Vital to Crafting Quality Regulation

Public input is at the heart of the APA's design for federal agency rulemaking. The most well-known process for soliciting such public input is the APA's notice-and-comment rulemaking process, through which an agency proposes a rule and provides an opportunity for public comment that must be considered in the agency's decision to finalize the rule proposal.

The APA does not specify a minimum number of days that the rule proposal be available for public comment, but an agency must "provide a meaningful opportunity to comment."[32] Federal executive guidance generally considers 60 days to be the minimum time for public comment, although the SEC, as an independent agency, is not bound by this guidance.[33] The SEC, however, prior to the current Chairman, by and large, allowed 60 days for public comment on rule proposals.[34]

In contrast, the current SEC has simultaneously advanced a more aggressive rulemaking agenda—putting forth more rule proposals, more quickly—and provided less opportunity for public comment on such rules.[35] These rule proposals, running hundreds of pages long and often asking for public comment on hundreds of questions, have been complex and interconnected, increasing the burdens on public commenters to analyze and respond meaningfully to the proposals.[36] This burden is only intensified for smaller market participants and those with fewer resources to devote to commenting on rule proposals. The extent of this issue was apparent with the package of four rules affecting equity market structure that were proposed simultaneously in December 2022.[37] But the issue generally plagues this SEC's policy-making agenda, which has failed to take into consideration rule complexity and overall rulemaking burden in setting the time period for public comment.[38]

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[32] *National Lifeline Association v. FCC*, 921 F.3d 1102, 1117 (D.C. Cir. 2019).
[33] *See, e.g.,* Executive Order 13563 (January 18, 2011), https://obamawhitehouse.archives.gov/the-press-office/2011/01/18/executive-order-13563-improving-regulation-and-regulatory-review; *see also* Executive Order 12866 (October 4, 1993), https://www.archives.gov/files/federal-register/executive-orders/pdf/12866.pdf.
[34] *See* Jennifer J. Schulp and Nicholas Anthony, "The SEC Short-Changes Public Comment," *Cato At Liberty*, January 14, 2022, https://www.cato.org/blog/sec-short-changes-public-comment.
[35] *See, e.g.,* Securities Industry and Financial Markets Association, "SEC Rulemaking Agenda," accessed March 18, 2024, https://www.sifma.org/explore-issues/sec-rulemaking-agenda/.
[36] Committee on Capital Markets Regulation, "Regulatory Incidence of SEC Proposed & Final Rulemakings (Gensler Chairmanship, April 17, 2021 through July 10, 2022," July 15, 2022, https://www.capmktsreg.org/wp-content/uploads/2022/07/sec-rulemaking-diagram.pdf (chart showing interconnectedness of SEC rule proposals).
[37] *See* Jennifer J. Schulp, Comment on File No. S7-31-22 Order Competition Rule, March 31, 2023, https://www.cato.org/sites/cato.org/files/2023-04/Schulp-Order-Competition-Comment-Letter-3.31.23.pdf (describing interconnectedness of rule proposals on order competition, Exchange Act Rule 605, best execution, and tick sizes, along with yet-to-be-implemented SEC rule on consolidated market data).
[38] *See, e.g.,* Letter from Alternative Credit Council, *et al*. to Gary Gensler, "Re: Importance of Appropriate Length of Comment Periods," April 5, 2022, https://fsforum.com/a/media/importance-of-appropriate-length-of-comment-periods.pdf.

Although the SEC's comment periods for more recent rule proposals have returned to more historical norms after receiving bipartisan criticism of the shortened timeframes,[39] Congress should consider setting a baseline for comment period length for SEC rule proposals. In light of the general complexity of SEC rules—including the length of proposals and the interconnectedness of proposals and existing rules—30-day time periods for public comment should be strongly disfavored.

The SEC's limitations on receiving meaningful input from the public on its rulemaking are not limited to the initial notice and comment process, however. Several of the SEC's finalized rules differ significantly from the proposals. While this could be seen as an encouraging sign that the agency is considering public feedback on the rule, where such rules substantially differ from the proposal, the public should be given another opportunity to comment on what should be viewed as a new proposal.[40]

Such a re-proposal would ensure that commentors are able to focus on salient issues with the current proposal—which may not have received attention due to the prioritization of issues with the prior proposal. The climate-risk disclosures rule provides a good example of this. The original proposal ran to more than 90 pages and sought comment on more than 200 individual questions;[41] it is more than reasonable to expect that commentors would focus on particular issues. But because the final rule differed significantly from the proposal, comments made on the proposal may differ from comments that would have been made on what the Commission finalized. As Commissioner Mark Uyeda explained, the Commission "essentially admitted that the proposal did not get it right."[42] And under such circumstances, the rule should be reproposed for comment by the public.

Finally, the SEC fails to give due weight to public input through the APA's petition for rulemaking process. The petition for rulemaking essentially restates the First Amendment right to petition the government.[43] Under the APA, "[e]ach agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule."[44] The APA requires the

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[39] *See, e.g.,* Letter from Jon Tester, *et al.* to Gary Gensler, accessed March 18, 2024, https://static.politico.com/04/e6/61483da64abface61f1b8994fc33/senatedemocrats-secchairgensler.pdf; Letter from Patrick McHenry and Pat Toomey to Gary Gensler, January 10, 2022, https://financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf.

[40] *See* 5 U.S.C. § 553(b)(3) (requiring notice of "either the terms and substance of a proposed rule or a description of the subject and issues involved").

[41] Securities and Exchange Commission, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," Proposed Rule, https://www.sec.gov/files/rules/proposed/2022/33-11042.pdf (SEC version).

[42] Mark T. Uyeda, "A Climate Regulation under the Commission's Seal: Dissenting Statement on The Enhancement and Standardization of Climate-Related Disclosures for Investors," Statement, March 6, 2024, https://www.sec.gov/news/statement/uyeda-statement-mandatory-climate-risk-disclosures-030624#_ftnref7.

[43] *See* Congressional Research Service, "Petitions for Rulemaking: An Overview," January 23, 2020, at 5, https://sgp.fas.org/crs/misc/R46190.pdf.

[44] 5 U.S.C. § 544(e).

petition to be acted on within a "reasonable time."[45] While agencies have different procedures for handling such petitions,[46] the SEC's publicly available procedures provide little guidance as to how the agency will handle a petition.[47] And it is clear that the Commission adheres to no timetable in acting on such petitions. For example, the New Civil Liberties Alliance petitioned the SEC to revise Commission Rule of Practice 202.5(c), relating to the Commission's policy on no admit/no deny settlements, on October 30, 2018.[48] The petition was finally acted on more than *five years* later—on January 30, 2024, in the midst of relevant litigation relating to the underlying policy.[49]

The Commission displays petitions for rulemaking that it has received on its website, which shows 244 petitions going back to 2001.[50] But there is no way to determine whether such petitions have been acted upon by the Commission, let alone the length of time that the petition was pending before action was taken.[51] The Administrative Conference of the United States recommends that agencies adopt procedures that provide an expected length of time for the agency to respond, as well as provide an explanation for any agency delay.[52] But, at a minimum, the SEC must do more to demonstrate that it is considering petitions for rulemaking in a timely manner.

The SEC Must Engage in Robust Analysis of a Rule's Costs and Benefits

The APA requires the SEC to weigh, and where possible quantify, the costs and benefits of a proposed regulation.[53] A series of court decisions more than a decade ago confirming that the SEC must undertake a quantitative cost-benefit analysis led to the Commission establishing

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[45] 5 U.S.C. § 555(b).
[46] Congressional Research Service, "Petitions for Rulemaking: An Overview," January 23, 2020, https://sgp.fas.org/crs/misc/R46190.pdf.
[47] 17 C.F.R. § 201.192.
[48] New Civil Liberties Alliance, Petition to Amend, October 30, 2018, https://www.sec.gov/files/rules/petitions/2018/petn4-733.pdf.
[49] Gary Gensler, "Statement on the Denial of a Rulemaking Regarding the Commission's No-Admit/No-Deny Policy," Statement, January 30, 2024, https://www.sec.gov/news/statement/gensler-denial-rulemaking-petition-013024.
[50] Securities and Exchange Commission, "Petitions for Rulemaking Submitted to the SEC," accessed March 18, 2024, https://www.sec.gov/rules/petitions.
[51] Compare with the petitions for review listed by the Consumer Financial Protection Bureau which lists whether petitions are open or closed. Consumer Financial Protection Bureau, "Petitions for rulemaking," accessed March 18, 2024, https://www.consumerfinance.gov/rules-policy/petitions-rulemaking/?page=1.
[52] Administrative Conference of the United States, "Adoption of Recommendations," 49 Fed. Reg. 75114, December 17, 2014, https://www.federalregister.gov/documents/2014/12/17/2014-29546/adoption-of-recommendations. Other agencies face statutory requirements with respect to their responsiveness to petitions for rulemaking, including the Federal Motor Carrier Safety Administration (Fixing America's Surface Transportation Act, P.L. 114-94, 49 U.S.C. § 113 note) and the Secretary of the Interior in connection with the Endangered Species Act (16 U.S.C. § 1553(b)(3)).
[53] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005); *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

its own guidance for economic analysis in SEC rulemakings.[54] Despite this internal guidance, however, the Commission continues to have rules invalidated by courts on the basis of an inadequate assessment of a proposed regulation's costs and benefits.[55]

Moreover, the SEC's economic analyses often fail to account for costs associated with the rule, while weighing quantified costs against speculative benefits. This is particularly apparent where the SEC has made interconnected rule proposals but does not analyze the impact—of either costs or benefits—of each proposal on the other.[56]

Requiring a robust cost-benefit analysis forces the agency to "show its work" in determining that a regulation is justified. Weighing such costs and benefits is not foreign to the SEC, which is required to analyze, among other things, the impact of its rule proposals on the Commission's mission to protect investors, promote efficiency, competition, and capital formation;[57] the burden a rule proposal places on competition;[58] and the proposed rule's economic impact on small entities.[59] A clear legislative requirement for the Commission to provide an evidence based-articulation of how and why the benefits of a proposed rule exceed the economic costs thereof, rather than reliance on the agency's internal guidance (which has no legal force and can be changed) may assist in shoring up the duty that exists under the APA to quantify, to the extent possible, the costs and benefits of the rule.

It's important to note that the Commission's own aggressive rulemaking agenda may be contributing to an inability to perform robust analysis of proposed rules. The Commission requested ten new positions for fiscal year 2024 in its Division of Economic and Risk Analysis to "directly support the Commission's rulemaking agenda."[60] This suggests that the Commission lacks adequate staff to conduct cost-benefit analyses, despite their own best efforts. The question of whether the Commission has adequate staff to address its aggressive rulemaking agenda affects more than economic analysis. As the SEC's Inspector General noted, the heavy rulemaking agenda can also increase the risk of errors because it "potentially (1) limits the time available for staff research and analysis," and (2) increases litigation risk."[61]

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[54] Securities and Exchange Commission, "Current Guidance on Economic Analysis in SEC Rulemakings," Memorandum, March 16, 2012, https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.
[55] *See, e.g., Chamber of Commerce v. SEC*, 85 F.4th 760 (5th Cir. 2023) (share repurchase rule).
[56] *See, e.g.,* Jennifer J. Schulp, Comment on File No. S7-31-22 Order Competition Rule, March 31, 2023, https://www.cato.org/sites/cato.org/files/2023-04/Schulp-Order-Competition-Comment-Letter-3.31.23.pdf.
[57] 15 U.S.C. § 77b(b), 15 U.S.C. § 78c(f), and 15 U.S.C. § 80a-2(c).
[58] 15 U.S.C. § 78w(a)(2).
[59] 5 U.S.C. § 604.
[60] Securities and Exchange Commission, "Fiscal Year 2024 Congressional Budget Justification," at 36, https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf
[61] The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2022, at 8, https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf. It's worth noting that the Inspector General

Finally, the SEC should also increase its use of retrospective rule reviews, particularly where the agency finalizes a rule based on benefits or costs that it has deemed difficult to quantify. A regularized process for revisiting some subset of the Commission's rules—that, at a minimum, presents public findings—would ensure the Commission's (as well as the public's) evaluation of whether such rules are functioning as intended. It would also allow analysis as to whether the rule is justified by reviewing actual—rather than predicted—costs and benefits.[62]

Holding the SEC to High Standards in the Exercise of its Functions

Separate and apart from its rulemaking functions, the SEC has struggled with its own cybersecurity and information technology functions. As the SEC's Inspector General has recognized,

> cyber risks are growing, and cyberattacks targeting critical infrastructure—including financial services—could affect entire systems and result in catastrophic financial loss. Individuals or groups with malicious intentions attempt to intrude into agency systems to obtain sensitive information, commit fraud and identity theft, disrupt agency operations, or launch attacks against other systems and networks. Even in the absence of those intentions, inadequate safeguards can lead to the unauthorized disclosure, modification, use, or disruption of information that can compromise the integrity of agency operations. Therefore, the SEC must continue to take steps to safeguard the security, integrity, and availability of its information systems and sensitive data.[63]

Yet, the Commission continues to suffer from embarrassing cybersecurity incidents, which have market impacts and erode confidence in the agency.[64]

The first step in addressing such challenges is to right-size the information that the Commission is collecting in the first place. One such reform would be to prohibit the SEC from collecting personally identifiable information from investors through the Consolidated Audit Trail (CAT). Not only does the collection of such information raise serious constitutional

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also raised concerns by some managers that the heavy rulemaking agenda has meant that "that fewer resources have been available to complete other mission-related work, as rulemaking teams have borrowed staff from other organizational areas to assist with rulemaking activities." *Id.*

[62] Requiring this process to be regular, or triggered automatically, helps to ensure that the rule can be revisited regardless of whether the rule is a priority of the then-sitting SEC Chairman. The requirement under Dodd-Frank that the SEC undertake a periodic review of the accredited investor definition serves such a purpose in requiring the Commission to evaluate and make any adjustments to the regulatory definition. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413, 124 Stat. 1376 (2010).

[63] The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2022, at 14, https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.

[64] *See, e.g.*, Douglas Gillison, "US SEC blames 'SIM swapping' for its X account hack," *Reuters*, January 22, 2024, https://www.reuters.com/technology/cybersecurity/us-secs-x-account-hacked-with-sim-swapping-agency-says-2024-01-22/.

concerns,[65] it also presents a concern as to whether the SEC—or really any entity—can appropriately safeguard such information.[66] As SEC Commissioner Peirce recognized, the "sheer value and size of the database will make the CAT an inviting target," and it is not at all clear that any gains to the ability of the SEC to bring enforcement cases are outweighed by the risks to individuals of warehousing this information in the CAT.[67]

The next step is to ensure that the agency is identifying and promptly remedying cybersecurity and information technology weaknesses. Under the Federal Information Security Modernization Act of 2014 (FISMA), the SEC must undergo an annual independent evaluation of its information security program and practices, overseen by the SEC's Office of Inspector General. The agency's performance on such audits, however, has been lagging. The Inspector General's most recent report to Congress identified a long list of recommendations relating to cybersecurity that had not yet been implemented, going back to 2018.[68] And the most recent Inspector General report about the SEC's management and performance challenges warns that "[f]ailure to timely and effectively implement government-wide zero trust cybersecurity principles may result in the SEC being more susceptible to threat campaigns that target the agency's IT infrastructure, threaten privacy, damage the American economy, and weaken trust in government."[69] While it looks like the SEC finally may have implemented outstanding recommendations,[70] such progress is hardly encouraging given the delay.

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[65] *See* Brief of the Cato Institute and Investor Choice Advocates Network As Amici Curiae In Support of Petitioners," *American Securities Association v. SEC*, No. 23-13396 (11th Circuit), February 15, 2024, https://www.cato.org/sites/cato.org/files/2024-02/legal-brief-2-15-24-asa-v-sec.pdf.

[66] *See* Jennifer J. Schulp, "The SEC Is Starting a Massive Database of Every Stock Trade," *Reason*, February 17, 2023, https://www.cato.org/commentary/sec-starting-massive-database-every-stock-trade. Indeed, the SEC's Inspector General noted that the "SEC also faces cybersecurity challenges with respect to its access, use, and security of data available through" CAT. The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2022, at 17, https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.

[67] Hester M. Peirce, "Statement of Hester M. Peirce in Response to Release No. 34-88890; File No. S7-13-19," Statement, May 15, 2020, https://www.sec.gov/news/public-statement/peirce-statement-response-release-34-88890-051520.

[68] Office of Inspector General, "Semiannual Report to Congress 04.01.23 to 9.30.23," *Securities and Exchange Commission*, at 24, https://www.sec.gov/files/semiannual-report-congress-april-1-2023-through-september-30-2023.pdf. For fiscal years 2021-2023, the outside auditor found that the SEC did not "meet the annual Inspector General FISMA reporting metrics' definition of "effective." *Id.* at 2; The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2023, at 22, https://www.sec.gov/files/statement-secs-management-and-performance-challenges-october-2023.pdf; The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2022, at 18, https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.

[69] The Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," *Securities and Exchange Commission*, October 2023, at 22, https://www.sec.gov/files/statement-secs-management-and-performance-challenges-october-2023.pdf.

[70] Office of Inspector General, "Fiscal Year 2023 Independent Evaluation of the U.S. Securities and Exchange Commission's Implementation of the Federal Information Security Modernization Act of 2014" *Securities and*

As the SEC recognizes for the entities that it regulates, "[m]anaging cyber and information risks is critical to the operation of the financial markets."[71] Yet, despite the FISMA auditing requirements, the SEC continues to encounter information technology and information security challenges at what seems like an alarming rate. Within the past two years alone, the SEC has suffered from a hack of its X account falsely announcing that the SEC had approved a Bitcoin exchange traded product, a problem with the SEC's internet comment form that resulted in comments for at least eleven proposed rulemakings not being received by the agency,[72] and a control deficiency that resulted Division of Enforcement staff being able to access documents created by the agency's administrative law judge function.[73] None of these was without consequence: the X hack moved the market price of Bitcoin, the comment letter form error required the SEC to reopen comment periods for 11 pending rulemakings, and the breach between enforcement and the administrative law judges resulted in the dismissal of 42 pending administrative actions.

Based on these problems, as well as issues identified by the SEC's Inspector General, it does not appear that the agency holds itself to the same standards that it imposes on the entities that it regulates.[74]

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Thank you for the opportunity to provide this information about the need for reform at the SEC to increase agency's accountability and transparency, to ensure adequate input and analysis on agency rulemaking, and to hold the agency to high standards in the exercise of its functions. I welcome any questions that you may have.

Exchange Commission, December 20, 2023, at 4, https://www.sec.gov/files/fy-2023-independent-evaluation-sec-implementation-fisma-2014-report-no-580.pdf ("The SEC also noted that OIT's progress toward a strong information security program can be further seen through its successful remediation of 14 prior-year FISMA evaluation recommendations in FY 2023.").

[71] Securities and Exchange Commission, "Fiscal Year 2024 Congressional Budget Justification," at 117, https://www.sec.gov/files/fy-2024-congressional-budget-justification_final-3-10.pdf. Indeed, more than 300 SEC exams annually since 2020 have requested information about an entity's information security. *Id.*

[72] *See* Letter from Katherine H. Reilly to Gary Gensler regarding "Final Management Letter: Review of SEC Controls Over Public Comments Submitted Online and Actions Taken In Response to a Known Error," April 14, 2023, https://www.sec.gov/files/finl-mgmt-ltr-review-sec-controls-over-public-comments-submitted-online-and-actions-taken-response.pdf.

[73] *See* Securities and Exchange Commission, "Second Commission Statement Relating to Certain Administrative Adjudications," Statement, June 2, 2023, https://www.sec.gov/news/statement/second-commission-statement-relating-certain-administrative-adjudications.

[74] *See, e.g.*, Securities and Exchange Commission, Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, Release Nos. 33-11216, 34-97989 (July 26, 2023), https://www.sec.gov/files/rules/final/2023/33-11216.pdf; Securities and Exchange Commission, "SEC Announces Three Actions Charging Deficient Cybersecurity Procedures," Press Release, August 30, 2021, https://www.sec.gov/news/press-release/2021-169.

Written Testimony of

Alexandra Thornton, Senior Director

Center for American Progress

Before the United States House of Representatives Financial Services Committee

Subcommittee on Capital Markets

Hearing on "SEC Overreach: Examining the Need for Reform"

March 20, 2024

Chairwoman Wagner, Ranking Member Sherman, and esteemed members of the subcommittee, thank you for the opportunity to appear before you today to discuss institutional reforms of the Securities and Exchange Commission (SEC).

My name is Alexandra Thornton. I am senior director of financial regulation at the Center for American Progress, an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action.

The Commission's Rulemaking and Comment Periods

The Administrative Procedure Act, which governs the procedures federal agencies must follow when making rules and adjudicating agency matters,[1] requires an agency in an informal rulemaking process to provide a meaningful opportunity for the public to provide written comments on a proposed rule.[2]

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[1] Administrative Procedure Act, 5 U.S.C. Sections 551-559.
[2] 5 U.S.C. Section 553(c).

Courts have made it clear that the point of this process is for the agency to solicit relevant information, so that it can "examine the relevant data and articulate a satisfactory explanation for its action, including a 'rational connection between the facts found and the choice made.'"[3]

Neither the statute nor the court opinions interpreting the statute require an agency to agree with, or make changes in response to, every comment. Rather, the agency is simply required to make a reasonable effort to collect relevant information and explain why it is taking a course of action, as informed by that information.

That is not what is happening now.

Instead, opponents of SEC rulemakings who seek to stop agency actions are misusing reasonable administrative process protections and turning them into years-long gauntlets for agency actions. Unfortunately, a handful of relatively recent court decisions have made this process far more burdensome on the agency and thrust important rules into jeopardy. These outside pressures have added unreasonable expectations for the administrative process, burdening the SEC and impeding its ability to do its job of protecting investors and promoting more fair, orderly, and efficient capital markets.

One of the most prominent ways to stop or slow agency actions is through manipulation of the comment process. Recently, opponents of commission actions have claimed that they have had inadequate time to consider proposals and offer meaningful insights. At the same time, opponents have also pursued a strategy of storming the agency with comment letters, often raising superfluous arguments. Thereafter, these opponents frequently challenge final rules in court, claiming that the agency inadequately addressed concerns they raised in their comments.

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[3] *Susquehanna Int'l Group v. SEC*, 866 F.3rd 442 (D.C. Cir. 2017) (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. US*, 371 U.S. 156, 168 (1962).

In response to these attacks, the commission has begun to bend over backward to allow for lengthy periods of comment. The typical time between when an action is proposed and finalized is now one or more years. While a formal comment period may last 30 days, 60 days, or even more, the SEC routinely considers comments received well outside those windows, even though it is not legally required to do so. Further, the agency has repeatedly, for complex proposals, re-opened formal comment periods to seek further clarification and more detailed information. And the agency has also offered its own supplemental analyses to its proposals to the comment file, so that market participants may have further information for their own analysis. None of this was prevalent for most of the agency's history.

An even more striking change in how the agency approaches its rulemakings is that it seems to seek to address nearly every point raised by commenters, regardless of the relevance, and even with respect to comments submitted long after the end of the comment period. While this may have been possible in the days when the SEC commonly received only a handful of comments on even its most controversial proposals, the impact of this approach is nearly impossible today, when the SEC often receives hundreds, thousands, or even tens of thousands of comments on many rules. Even though the agency is not legally required to address all the issues raised by all commenters in its final rules, the agency staff have begun to dedicate hundreds of pages in their final rule releases to these not-legally-mandated reviews of what may be erroneous or irrelevant comments.

Separately, the commission's economic analyses have become longer and much more complex.

The two very different rules released on March 6—a couple weeks ago—are a perfect example.[4] That day, a divided commission adopted the climate disclosure rule, now stayed. And a unified commission adopted a rule to update disclosures by trading centers related to execution of equities orders.

Both rules adopted that day were contemplated by the SEC and businesses for well over a decade prior to the rules even being proposed.

The climate disclosure rule was preceded by 2010 guidance on disclosure of climate-related risks and a 2021 public Request for Information.[5] Market participants were calling for updates to order execution disclosures, called Rule 605, for years, and the SEC's Equity Market Structure Advisory Committee considered changes to the rule in 2016. Both rules had been the subject of petitions from industry seeking to have the SEC propose or modify rules. With a 90-day comment period in each case and well over a year between the proposed and the final rule in each case, during which the commission continued to accept and consider comments, the proposals subsequently advanced by the commission together totaled 1,472 pages.[6] Even before the economic analyses, which together amounted to more than 500 pages, the adopting releases contained hundreds of pages in which the commission restated and responded to issues raised in the thousands of comments received. As anyone who has reviewed these rules will admit, many of the comments and analysis are repetitive and either superfluous or arguably irrelevant.

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[4] See Open Meeting Agenda, Wednesday, March 6, 2024, available at https://www.sec.gov/os/agenda-open-030624, considering "The Enhancement and Standardization of Climate-Related Disclosures for Investors" and "Disclosure of Order Execution Information for National Market System Stocks" (Rule 605).
[5] See, Statement of Commissioner Allison Herron Lee, "Public Input Welcomed on Climate Change Disclosures," U.S. Securities and Exchange Commission, March 15, 2021, available at https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
[6] Final rule, "Disclosure of Order Execution Information," 586 pages, available at https://www.sec.gov/files/rules/final/2024/34-99679.pdf; and Final Rules, "The Enhancement and Standardization of Climate-Related Disclosures for Investors, 886 pages, available at https://www.sec.gov/files/rules/final/2024/33-11275.pdf.

The result of all this analysis is paralysis. It is typically years from the time a rule is considered by businesses, investors, and other market participants to the development of a proposal, the submission and analysis of comments, and adoption of a final rule. As the agency's agenda shows, many rules sought by businesses and investors, respectively, have yet to be proposed, much less finalized.[7]

The ability of thousands of market participants, including larger companies and financial firms, to overwhelm the agency with letters far outstrips the agency's ability to sift through the morass. The agency simply does not have enough staff to engage in this strained analysis for thousands of comments on every single rulemaking.

Notably, this paralysis is typically one-sided. Despite the agency's clear mission to protect investors and to promote fair and efficient capital markets, there generally is not this type of analysis for deregulation. For example, a 2020 final rule released under Chair Jay Clayton that set up procedural hurdles for investors seeking to offer proxy proposals was only 247 pages long with only 72 pages of economic analysis.[8] Rules designed to protect investors, such as through requiring disclosures, are layered with a massive regulatory burden, while rule revisions to benefit industry at the expense of investors generally are not.

Policy Interpretation

At the request of market participants, the commission routinely provides interpretive guidance (including "frequently asked questions"), no-action letters, and exemptive orders, which lead to changes in how its rules are implemented and enforced. Over the past several years, the agency and its staff have

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[7] Office of Information and Regulatory Analysis, Agency Rule List – Fall 2023, Securities and Exchange Commission, available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode&showStage=active&agencyCd=3235.

[8] See "Exemptions from the Proxy Rules for Proxy Voting Advice," October 2020, available at https://www.sec.gov/files/rules/final/2020/34-89372.pdf.

taken hundreds of these actions, impacting nearly every aspect of the capital markets, ranging from how companies review shareholder proxy proposals, to how investment managers pay for research, to how brokers comply with their capital rules.[9] Like formal agency rules, these other agency activities are now also increasingly being challenged in the courts.[10]

No-action letters and exemptive orders have the effect of changing allowable behavior of market participants, often by effectively permitting what would otherwise not be permitted activity. Interpretive guidance provides more detail on how the commission will apply a rule and is often used to shape the policies, procedures, and practices of firms seeking to comply with rules. These actions, regardless of their statutory basis or standing as a "final action" of the agency, can materially change the contours of the rules and the markets. The processes used by the agency and its staff to issue guidance and no-action letters, in particular, usually do not involve obtaining broader public comment on the facts in advance. As such, they may be opaque or subject to potential errors.

While the SEC staff may do its best to identify the relevant facts and issues, they or the agency more broadly may take actions based on incomplete, inadequate, or erroneous information.

To ensure the integrity of agency actions, provide clarity to market participants, and preserve the agency's ability to interpret and apply its rules without unnecessary risk of judicial second-guessing, the agency should revise its internal procedures for adopting interpretive guidance, no-action letters, and exemptive orders to ensure that they are sufficiently public and detailed before their adoption or release. It is only through a transparent process that courts and the public can have confidence that

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[9] Staff No Action, Interpretive and Exemptive Letters, U.S. Securities and Exchange Commission, available at https://www.sec.gov/regulation/staff-interpretations/no-action-letters (last accessed March 2024).
[10] See, e.g., *CBOE Futures Exchange LLC v. SEC*, No 21-1038 (D.C. Cir. 2023), available at https://cases.justia.com/federal/appellate-courts/cadc/21-1038/21-1038-2023-07-28.pdf?ts=1690556595; and *Clarke, et.al. v. CFTC*, No. 22-51124 (5th Cir. 2023), available at https://www.ca5.uscourts.gov/opinions/pub/22/22-51124-CV0.pdf.

these activities are based upon the relevant facts and that the actions taken are reasonably connected to those facts.[11] This minimal procedural safeguard should apply to all interpretive guidance, no-action letters, and exemptive orders, regardless of their legal status.

Consolidated Audit Trail (CAT)

In 2012, two years after first proposing it, the SEC adopted a rule to provide for the creation and adoption of a consolidated audit trail. Now, more than a dozen years later, some in the financial services industry have continued to lodge substantive and procedural challenges to the Consolidated Audit Trail, arguing that it is somehow an unprecedented, illegal collection of information or subject to inadequate agency considerations. This is not true.

The SEC has clear statutory authority to oversee securities trading markets, and it has, for decades, ensured that orders to buy or sell securities, and trade executions, are reported to regulators. For decades, FINRA maintained the Order Audit Trail System (OATS), which it used to collect orders and trading-related information. FINRA (in conjunction with the SEC) has also developed very frequently used procedures to help match that trading to specific firms and individuals with which all broker-dealers are familiar.

Once the Consolidated Audit Trail (CAT) was up and running (after more than a decade of rulemakings, regulatory orders, and actions), FINRA retired OATS, essentially replacing brokers' reporting obligations under OATS with the revised CAT reporting obligations. As a result, the Consolidated Audit Trail provides the principal means for regulators to identify trading manipulations and abuses and investigate them.

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[11] See, e.g., Comment letter, Healthy Markets Assn., regarding Petition for Rulemaking for Exemption and NO-Action Relief Requests," Securities and Exchange Commission, October 18, 2023.

In today's high-speed markets, abuses are often undetectable without knowing who is doing the trading. If one trader enters 25 orders to buy stock in 25 different venues to create the appearance of broad "market demand," when there is no such demand, it may be engaging in illegal spoofing. However, if there really were 25 different traders submitting those orders, then nothing nefarious is occurring. The regulators need to know the difference if they are to protect the integrity of the markets.

This is not a hypothetical risk. Cross market, complex market manipulation strategies were sadly common prior to the implementation of the CAT, and even played a role in the May 6, 2010, Flash Crash.[12]

While the decades-old reporting requirements and regulatory processes allowed the SEC to ultimately link traders to their trading activities, it was not sufficiently automated to allow for effective oversight in the complex, high-speed, marketplace.

The CAT does not generally collect novel information that was previously unavailable to regulators. In fact, using the well-known "blue sheet" process, regulators can currently collect trader-specific personally identifiable information (PII). Specifically, as FINRA explains on its website:

> Electronic Blue Sheet (EBS) data files, which contain both trading and account holder information, provide regulatory agencies with the ability to analyze a firm's trading activity. Firms are expected to provide complete, accurate and timely Blue Sheet data in response to regulatory requests. Incomplete, inaccurate and untimely Blue Sheet data

[12] Andy Verity & Eleanor Lawrie, "Hound of Hounslow: Who is Navinder Sarao, the 'flash crash trader'?" BBC, January 28, 2020, available at https://www.bbc.com/news/explainers-51265169.

> compromises regulators' ability to identify individuals engaging in insider trading schemes and other fraudulent activity. [13]

The CAT simply ties together information that was historically available, but not in a useful way.

The complaints now being lodged against the CAT's purportedly unprecedented collection of information ring hollow, given that regulators have for decades collected and had access to the information.[14] The hyperbolic arguments being launched against the CAT simply were not made when OATS was adopted, nor are they being made now against the continuing blue sheet process. Further, many federal regulators, most notably, the Internal Revenue Service, collect far-more personal information than is being sought here.

Further, to address concerns raised by some market participants about the personally identifiable information (PII), in the more-than-a-decade since the CAT rule was first proposed, the agency and self-regulatory organizations in charge of it have taken unprecedented steps to protect PII. For example, regulators do not have access through the CAT to PII information directly now, but rather through a masked identifier. The actual human PII is only available upon further investigation.

There is no credible legal challenge to the SEC's authority to collect the information contained in the Consolidated Audit Trail. And given that the CAT has been subject to numerous rulemakings, orders, and implementation plans spanning over 14 years, it cannot be said that the CAT has not received sufficient regulatory consideration.

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[13] Electronic Blue Sheets, FINRA, available at https://www.finra.org/filing-reporting/electronic-blue-sheets-ebs.

[14] See generally, Statement of Tyler Gellasch, Executive Director of Healthy Markets Association, *Implementation and Cybersecurity Protocols on the Consolidated Audit Trail* Before the House Financial Services Committee, Subcommittee on Capital Markets, Securities and Investment, Nov. 30, 2017.

The renewed complaints about the CAT may relate to the SEC's recent approval of the funding mechanism used to pay for the creation and operation of the CAT. That Funding Order is also being challenged in court, but the challenge is not about the merits of the CAT.

Private Fund Advisers Rule

Among the legislative proposals being considered by the subcommittee today is one that calls for congressional disapproval of the Private Fund Advisers rule finalized last September.[15] The rule requires private funds and their advisers to provide investors with regular account statements, standardized fee and expense information, and basic disclosures regarding their conflicts of interest. It will also require private funds to have annual audits. And the rule is well within the commission's authority to adopt rules reasonably designed to prevent acts, practices, and business activities that are fraudulent, deceptive, or manipulative.[16]

The Investment Advisers Act of 1940 requires firms or sole practitioners compensated for advising others about securities investments to register with the SEC and conform to regulations designed to protect investors.[17] Private funds have grown in size, complexity, and number in the past decade since the Dodd-Frank Act required private fund advisers to begin registering with the SEC.[18] Private funds have trillions of dollars-worth of assets under management, and, according to the SEC, more than 5,000 SEC-

[15] Securities and Exchange Commission, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," 88 Fed. Reg. 63206 st seq., available at https://www.federalregister.gov/documents/2023/09/14/2023-18660/private-fund-advisers-documentation-of-registered-investment-adviser-compliance-reviews.
[16] 15 U.S.C. Section 80b-6(4).
[17] 15 U.S.C. Section 80b-1 through Section 80b-21.
[18] Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. Section 80b-4(b).

registered investment advisers, roughly 35 percent of all SEC-registered advisers, manage about $18 trillion in private fund assets.[19]

But while private fund advisers are theoretically already required to disclose significant relevant information under the Investment Advisers Act,[20] the SEC's Division of Examinations has found substantial concerns about the behavior of private fund advisers, including failure to act consistently with disclosures; use of misleading disclosures regarding performance and marketing; due diligence failures relating to investments or service providers; and use of potentially misleading "hedge clauses."[21] Another examination of private funds advisers found deficiencies relating to conflicts of interest; fees and expenses; and policies and procedures relating to material non-public information.[22]

The Private Fund Advisers rule addresses three common risks and harms in an adviser's relationship with private funds and their investors: lack of transparency, conflicts of interest, and lack of effective governance mechanisms for client disclosure, consent, and oversight.

Regular account statements and audits should be basic, mandatory protections for all investors against fraud and manipulation risks. Private fund advisers collecting hundreds of millions of dollars should be able to provide these basic protections. This should not be controversial.

Fees, costs, and performance information should be clearly disclosed and comparable, to prevent fraud and abuses. However, this information can be complicated and difficult to identify for even the most

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[19] See, Office of Compliance Inspections and Examinations (OCIE), "Observations from Examinations of Private Fund Advisers," U.S. Securities and Exchange Commission, January 27, 2022, available at https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf.
[20] See, 15 U.S.C. Section 80b-4.
[21] OCIE, January 27, 2022.
[22] Office of Compliance Inspections and Examinations, "Observations from Examinations of Investment Advisers Managing Private Funds," U.S. Securities and Exchange Commission, June 23, 2020, available at https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf.

sophisticated investors. Adopting standardized practices for calculating and disclosing fees, costs, and performance information is squarely within the SEC's investor protection mandate.

Disclosures of special arrangements between investors and private advisers protects all investors, while also promoting competition between investment advisers, and identifying discriminatory practices in the marketplace. It also helps deter fraud and abuses. Again, it is squarely within the SEC's authority and mission to require this information from private fund advisers.

The final rule prohibits private fund advisers from providing certain preferential treatment to one investor or group of investors, such as redemption rights, that could have material, negative effects on other investors, while requiring disclosure of all other types of preferential treatment. Again, even the most sophisticated investor may be unaware of such preferential terms provided to other investors, especially in an environment where typical public company disclosures do not exist.

This essential rule takes on heightened importance due to the rapid growth of private markets generally. Today, teachers, firefighters, and millions of other workers with public and private retirement plans are materially exposed to the private markets. And private fund advisers have significant control over those investments.

Concerns with Growth of Private Markets Generally

Over the past few decades, Congress and the SEC have dramatically expanded exemptions from application of the federal securities laws, including the registration and ongoing public reporting

requirements. This has led to the explosive growth of private markets, often at the expense of public markets.[23]

Now more capital is raised annually in the private markets than in the public markets. And while there has long been a requirement that companies with a large number of "holders of record" begin public disclosures and comply with the securities laws, a loophole has allowed companies to effectively avoid the law's application, even if they may have thousands or even millions of beneficial owners.

There are now more than 600 private companies in the U.S. with purported valuations exceeding $1 billion. Many of these companies have thousands of employees and sell products and services to tens of millions of Americans.

By allowing extremely large companies or valuable companies to avoid basic disclosure rules and safeguards, the private markets allow for waste, fraud, and abuses, not unlike those that pre-dated the adoption of the federal securities laws. Valuations of assets, disclosures on financials, reviews of internal controls, and more may range from lax to materially flawed, leading to billions of dollars wasted and lost savings to millions of Americans. This is not just true in the private equity and venture capital markets, but in the private debt markets as well.

As private funds and private companies become ever more prevalent and connected to the financial system and the future of American families and businesses, policy makers and regulators must pay attention to the enormous distortions these markets enable. Unlike public markets, private markets

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[23] See, generally, Tyler Gellasch, Alexandra Thornton, and Crystal Weise, "How Exemptions from Securities Laws Put Investors and the Economy at Risk," Center for American Progress, March 22, 2023, available at https://www.americanprogress.org/article/how-exemptions-from-securities-laws-put-investors-and-the-economy-at-risk/

allow special treatment for the most connected and powerful players, including preferential redemption rights and liquidity preferences and greater investment protections.

The SEC was created to be a disclosure regulator, requiring information from companies that want to raise capital from the public. But the wholesale expansion of exemptions from the public disclosure framework are dismantling the securities laws that have served the capital markets for so long and made U.S. capital markets the most liquid and trusted in the world.

During consideration of securities legislation in the 1930s, Congress considered making the SEC a merit regulator with authority to prevent securities offerings that did not meet standards of quality.[24] It rejected that idea with the understanding that companies would be required to make any disclosures that the SEC found to be "in the public interest and for the protection of investors."[25] This language is repeatedly mentioned in the statutes and legislative history of the securities laws. But the wholesale exemption of securities offerings from the public disclosure framework, has undermined congress's intent. The solution is either to give the SEC a stronger hand in making regulations aimed at protecting investors from investments they cannot possibly understand well enough to make a sound investment decision or, alternatively, to shrink the exemptions and close loopholes so that larger companies comply with the public disclosure framework, essentially moving them out of the private markets, and prevent

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[24] James M. Landis, "The Legislative History of the Securities Act of 1933," 28 Geo. Wash. L. Rev. 29 (1959-1960), available at https://heinonline.org/HOL/LandingPage?handle=hein.journals/gwlr28&div=7&id=&page=.

[25] See, for example, Securities Act of 1933, 15 U.S.C. Section 77g and Section 77j; Securities Exchange Act of 1934, 15 U.S.C. Section 78c(a)(27) regarding "rules of an exchange," Section 78c(51)(C) regarding rules for penny stocks, and Section 78c(f) on promotion of efficiency, competition, and capital formation." Section 78c(f) reads, "Whenever…the Commission is engaged in rulemaking…and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." See Legal Information Institute, "15 U.S. Code § 78c – Definitions and application," available at https://www.law.cornell.edu/uscode/text/15/78c (last accessed March 2024).

private companies from raising capital from retail investors directly or indirectly without providing the same types of disclosures that public companies make.

Thank you again for inviting me to testify today. I look forward to answering your questions.

american securities association
America's Voice for Main Street's Investors

March 20, 2024

The Honorable Ann Wagner
Chairwoman
Subcommittee on Capital Markets
U.S. House of Representatives
Washington, DC 20515

The Honorable Brad Sherman
Ranking Member
Subcommittee on Capital Markets
U.S. House of Representatives
Washington, DC 20515

Re: March 20th Hearing Entitled "SEC Overreach: Examining the Need for Reform"

Dear Chairwoman Wagner and Ranking Member Sherman:

The American Securities Association[1] submits this letter for the scheduled March 20th hearing of the Capital Markets Subcommittee to examine the recent overreach of the Securities and Exchange Commission (SEC) and the need for Congress to establish further guardrails for the agency.

I. Overview.

Over the last three years, the SEC has shown a blatant disregard for constitutional principles, congressional authority, and judicial oversight. It has undertaken the most aggressive and unauthorized regulatory agenda in modern SEC history. It has been sanctioned by a federal court for a "gross abuse of power."[2] It has misled Congress about control deficiencies in its enforcement division,[3] and the legality of its rulemakings have been challenged in court so many times we have lost count. Collectively, this has significantly damaged the public's trust and confidence in the agency.

In particular, the SEC has proposed or finalized rules that would drastically overhaul corporate disclosure, equity market structure, the regulation of private funds, the interactions between brokers and investment advisers with retail customers, and the trading environment for U.S. government securities. The SEC has done *all* of this without any directive, or even authorization, from Congress. In fact, in some instances – such as climate disclosure – the SEC has acted even though Congress has considered and declined to pass legislation that would grant the SEC the express authority to promulgate such a rule. It is little wonder that a substantial portion of the

[1] ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.
[2] https://cointelegraph.com/news/sec-s-conduct-in-debtbox-case-constituted-a-gross-abuse-of-power
[3] https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408389

SEC's rulemaking agenda is now in the hands of the courts, and that one major rule has already been vacated due to the SEC acting arbitrarily and capriciously.[4]

This SEC has also acted as if it is above the law. This was evidenced by a federal judge sanctioning the SEC after it was discovered that the SEC lied to the court to obtain an asset freeze against a private entity.[5] The SEC's behavior begs the question about what *other* SEC enforcement cases and settlements may have been based upon false information signed off by its enforcement director.

This Committee should also continue its work to investigate and expose the behavior of an SEC that operates as if the law doesn't matter. Reform of the SEC is needed, and it is imperative that Congress act decisively to take its power back.

Congress needs to act to prevent the SEC's unelected bureaucrats from using their power to transfer wealth from investors to special interests in the professional class who clamor for more and more unauthorized regulation. It can do this by expressly prohibiting the SEC from becoming a vehicle for promoting partisan political agendas and refocusing it on being a facilitator of nationwide capital formation for small businesses.

II. Legislation.

ASA commends the Committee for its initiatives, and we support several bills the Capital Markets Subcommittee will consider today. ASA is especially supportive of the following legislation:

A. H.R. 4551, the Protecting Investors' Personally Identifiable Information Act

H.R. 4551 would prohibit collection of investor personally identifiable information (PII) by the SEC's Consolidated Audit Trail (CAT). Without this change, the CAT will become the largest repository of sensitive investor information ever created and will become a prime target for cybercriminals and cyber armies supported by adversarial nations, especially China and Russia. As FBI Director Wray recently testified, the Chinese Communist Party (CCP) has become a constant threat to the privacy of Americans and is waiting to "wreak havoc" on America's critical infrastructure, which includes the CAT.[6]

There is absolutely no reason for the CAT to collect American investor PII. Investors should also be concerned that, in addition to cyberthreats, PII collection by the CAT will allow government officials to know exactly what stocks American's own.

[4] *Chamber of Commerce of the United States of America vs. SEC* (Challenging SEC stock buyback rule) Vacated December 19, 2023.
[5] SEC Blasted by Judge for 'Gross Abuse of Power' in Crypto Case. Bloomberg News (March 18, 2024) https://www.bloomberg.com/news/articles/2024-03-19/sec-blasted-by-judge-for-gross-abuse-of-power-in-crypto-case
[6] https://www.nbcnews.com/politics/national-security/fbi-director-warn-chinese-hackers-aim-wreak-havoc-us-critical-infrastr-rcna136524

This information opens a window into an individual's personal, religious, and political beliefs. Knowing whether a person owns shares in a green company, a gun company, an energy company, or a bank that will or will not do business with those companies reveals a lot about the policies a person supports. Once known, a politically motivated government can use this insight to target any American whose investments don't support the orthodoxy of those in power.[7]

This is especially dangerous if the SEC is led by an administrative state loyalist who believes that neither the law nor our founding document should constrain the government. Sadly, this describes the current Chairman.

ASA has appreciated the opportunity to work with Rep. Loudermilk and Sen. Kennedy on this legislation and we commend them for their leadership on this critical issue.

The CAT represents a dangerous threat to the American investing public that must be stopped. Congress must pass H.R. 4551 to end this big government surveillance scheme and protect the constitutional rights of Americans against the tyranny of the administrative state.

The ASA also supports legislation to be considered that would mandate a Government Accountability Office (GAO) study of the SEC's information technology infrastructure and its processes for handling sensitive data. This bill would help Congress and the public better understand the effectiveness or lack thereof of the SEC's own cyber policies.

B. H.R. 7902, the Protecting Private Job Creators Act

Rule 15c2-11 was adopted by the SEC in 2020 to address fraudulent behavior typically associated with trading in the over the counter (OTC) market by ensuring issuers quoted in the OTC market make current financial information publicly available. However, prior to the 2020 amendments, there has been limited, if any, application of this rule to fixed income markets, and for good reason.

If 15c2-11 were to be applied to the fixed income markets without first considering the consequences, it could weaken transparency and disrupt these markets, rather than enhance them.

Accordingly, we support this draft bill that would exempt 144A fixed income securities from Rule 15c2-11 because it would mitigate some of the negative consequences from the misapplication of Rule 15c2-11 while protecting investors in the fixed income markets.

C. Other Legislation

ASA also supports several other bills that will be considered during the hearing, including bills that would require the SEC to conduct a cost benefit analysis on prospective rules, a requirement

[7] https://www.washingtontimes.com/news/2024/mar/4/team-biden-wants-to-weaponize-stock-market/

for the SEC to retrospectively review past rulemakings, and a mandated minimum 60-day comment period for most SEC rulemakings. ASA also supports the disapproval resolution to overturn the SEC's 2023 private funds rule.

D. SEC Reform.

We also recommend this committee conduct an open debate with the American people about whether the SEC's five (5) person commission structure is constitutional, and if it is, then whether the SEC should continue to function in its current form.

In order to prevent a partisan Chairman from imposing an agenda on the American people that Congress did not authorize, it may be better to have an evenly divided commission that can only act with broad bipartisan consensus and explicit authorization from Congress.

If Congress does not do something to retake its power from the SEC, then it risks being limited to sending letters that go unanswered and complaining about policies it did not authorize. That scenario is not what the framers envisioned when they crafted the ***three***, not four, branches of government power under our Constitution.

III. Conclusion.

ASA appreciates the work that members of the Financial Services Committee are doing to hold the SEC accountable and enact lasting reforms for the agency. We look forward to continuing to work with all members of Congress on these critical issues, especially removing American investor PII from the CAT.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

Ranking Member Maxine Waters

Mr. David Burton

1. Which of the following options best describes your self-identified race? (you may choose more than one)
a. White or Caucasian
b. Black or African American
c. Hispanic/Latinx
d. Asian
e. Middle Eastern/North African
f. Choose not to answer
g. Prefer to self-describe (please specify)

2. Which of the following options best describes your gender identity?
a. Woman
b. Man
c. Non-binary
d. Transgender Man
e. Transgender Woman
f. Choose not to answer
g. Prefer to self-describe (please specify)

Regarding question no. 1:

(g) I am an American.

Regarding question no. 2:

(b) I am a man.

Sincerely,

David Burton

PATRICK McHENRY, NC
CHAIRMAN

MAXINE WATERS, CA
RANKING MEMBER

United States House of Representatives
One Hundred Eighteenth Congress
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

April 3, 2024

John Gulliver
Executive Director
Committee on Capital Markets Regulation
134 Mount Auburn Street
Cambridge, MA 02138

Dear Mr. Gulliver:

Thank you for testifying before the Subcommittee on Capital Markets of the House Committee on Financial Services on March 20, 2024, at the hearing titled "SEC Overreach: Examining the Need for Reform." Per the instructions announced by the Chairman at the conclusion of the hearing, Members submitted additional questions for your response. Please respond to the questions below and submit your response by May 1, 2024.

Should you or your staff have any questions or need additional information, please contact Rachel Collins at (202) 225-7502.

Sincerely,

Patrick McHenry
Chairman

Questions for the Record

Ranking Member Maxine Waters

Mr. John Gulliver

1. Which of the following options best describes your self-identified race? (you may choose more than one)
    a. White or Caucasian
    b. Black or African American
    c. Hispanic/Latinx
    d. Asian
    e. Middle Eastern/North African
    f. Choose not to answer
    g. Prefer to self-describe (please specify)

2. Which of the following options best describes your gender identity?
    a. Woman
    b. Man
    c. Non-binary
    d. Transgender Man
    e. Transgender Woman
    f. Choose not to answer
    g. Prefer to self-describe (please specify)

CATO INSTITUTE | Center for Monetary and Financial Alternatives

SEC Overreach: Examining the Need for Reform
Questions for the Record to Jennifer J. Schulp

Submitted June 25, 2024

Questions from Ranking Member Maxine Waters

1. Which of the following options best describes your self-identified race? (you may choose more than one)

a. White or Caucasian

b. Black or African American

c. Hispanic/Latinx

d. Asian

e. Middle Eastern/North African

f. Choose not to answer

g. Prefer to self-describe (please specify)

Answer: a. White or Caucasian

2. Which of the following options best describes your gender identity?

a. Woman

b. Man

c. Non-binary

d. Transgender Man

e. Transgender Woman

f. Choose not to answer

g. Prefer to self-describe (please specify)

Answer: a. Woman

CAP

Center for American Progress
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202.682.1611
americanprogress.org

April 29, 2024

The Honorable Patrick McHenry
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Re: Subcommittee on Capital Markets of the House Committee on Financial Services Committee hearing on March 20, 2024, titled "SEC Overreach: Examining the Need for Reform"

Dear Chair McHenry:

This letter is submitted in response to yours of April 3, 2024, requesting the I respond to additional questions submitted by Ranking Member Maxine Waters. My responses are below.

Question 1:
Which of the following options best describes your self-identified race?

a. White or Caucasian
b. Black or African American
c. Hispanic/Latinx
d. Asian
e. Middle Eastern/North African
f. Choose not to answer
g. Prefer to self-describe

Response: (a) White or Caucasian

Question 2:
Which of the following options best describes your gender identity?

a. Woman
b. Man
c. Non-binary
d. Transgender Man
e. Transgender Woman
f. Choose not to answer
g. Prefer to self-describe

Response: (a) Woman

Thank you for the opportunity to testify before the subcommittee and to respond to these follow-up questions.

Respectfully,

Alexandra Thornton
Senior Director
Center for American Progress

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