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New SEC Chairman Jay Clayton outlines views in policy speech

Two months after being sworn in as Chairman of the US Securities and Exchange Commission (SEC), Jay Clayton gave his first policy speech outlining the principles that will guide his actions as SEC Chair.[1]

In the 12 July speech at the Economic Club of New York, Chairman Clayton highlighted topics on the SEC agenda where the principles can be put into action. He observed that much of the SEC rulemaking required by the Dodd-Frank Act of 2010 was completed under former SEC Chair Mary Jo White's tenure, and that the SEC now has "considerably more discretion over its agenda."

The eight Clayton principles

- The SEC's mission is our touchstone
- Our analysis starts and ends with the long-term interests of the Main Street investor
- The SEC's historic approach to regulation is sound
- Regulatory actions drive change, and change can have lasting effects
- As markets evolve, so must the SEC
- Effective rulemaking does not end with rule adoption
- The costs of a rule now often include the cost of demonstrating compliance
- Coordination is key

[1] "Remarks at the Economic Club of New York," 12 July 2017, SEC website, www.sec.gov/news/speech/remarks-economic-club-new-york, accessed July 2017.

Clayton's principles for securities regulation

Highlights from Clayton's principles that may be of significance to the issuer and investor community include the following:

- **SEC mission and focus:** Clayton affirmed that the tripartite mission of the SEC — investor protection; maintenance of fair, orderly and efficient markets; and facilitation of capital formation — should be the touchstone for all SEC actions. He further noted that all three parts are critical, and that harm would result if the SEC were to "emphasize one of the canons without being mindful of the others." To determine whether the SEC is successfully carrying out its mission, Clayton indicated that the SEC's analysis should focus on the long-term interests of Main Street investors, whom he called "Mr. and Ms. 401(k)."

- **Rulemaking considerations:** Several of Clayton's principles focused on the rulemaking process:
  - Each new regulation brings about change that can have long-lasting effects and should be analyzed with a view to both its incremental and cumulative effects. Clayton noted that while each new requirement may not seem significant on its own, their buildup over time can significantly impact the market. As an example, he noted that some disclosure requirements have been added by not just the SEC but also by lawmakers and other regulators based on considerations "beyond the core concept of materiality," and that the cumulative effect of these requirements — all of which were justified individually at the time of their adoption — may have contributed to the decline in the number of IPOs and listed companies over the last two decades. Clayton also said that "studies show the median word-count for SEC filings has more than doubled over the last two decades, yet readability of those documents is at an all-time low."

> "Regardless of the cause, the reduction in the number of U.S.-listed public companies is a serious issue for our markets and the country more generally. To the extent companies are eschewing our public markets, the vast majority of Main Street investors will be unable to participate in their growth. The potential lasting effects of such an outcome to the economy and society are, in two words, not good."

  - When developing a new rule, the SEC should consider how market participants will demonstrate compliance, as this can add significantly to the cost of implementing the rule, particularly if third parties such as lawyers, consultants or accountants are involved. Clayton stated that "the Commission needs to make sure at the time of adoption that we have a realistic vision for how rules will be implemented as well as how we and others intend to examine for compliance."

> "It is incumbent on the Commission to write rules so that those subject to them can ascertain how to comply and — now more than ever — how to demonstrate that compliance. Vaguely worded rules can too easily lead to subpar compliance solutions or an overinvestment in control systems. We must recognize practical costs that are sure to arise."

  - The SEC's rulemaking process should include a retrospective review of how the rules are implemented in practice. This will allow the SEC to determine whether its rules are working as intended.

- **SEC evolution:** The SEC must evolve to ensure that it is responsive to current market realities, including by using technology and innovative approaches to address problems. At the same time, the SEC should be mindful of the costs to market participants of implementing regulatory change.

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- **Coordination:** The SEC should coordinate with other financial regulatory and law enforcement bodies to the extent possible to ensure a well-functioning regulatory environment, particularly where the SEC's jurisdiction overlaps with that of its counterparts. He noted that cybersecurity (i.e., addressing potential cyber threats and responding to a major cyber attack, should one arise) is one such area where coordination is critical.

SEC agenda

Clayton discussed topics on the SEC's agenda where these principles could be put into action.

- **Capital formation:** A key part of Clayton's agenda will be to improve the attractiveness of the public capital markets.
  - Clayton observed that many companies have taken advantage of the accommodations and phased-in disclosure requirements available to emerging growth companies (EGCs). He noted that the SEC recently extended one accommodation to all companies — specifically, all companies are now allowed to submit draft registration statements relating to IPOs for SEC staff review on a nonpublic basis, not just EGCs.[2] Further, the Division of Corporation Finance will also accept draft registration statements for nonpublic review during a company's first year in the SEC's reporting system.
  - Clayton also reminded companies that, in cases where certain financial statements are required that would not provide material benefit to investors and would be costly to obtain, Rule 3-13 of Regulation S-X allows companies to request SEC staff permission to omit this information or submit alternative information that might be of comparable benefit to investors at a reduced cost. He stated, "I want to encourage companies to consider whether such modifications may be helpful in connection with their capital raising activities and assure you that SEC staff is placing a high priority on responding with timely guidance."
  - Clayton acknowledged that the private capital markets are operating well and can offer a very attractive alternative to the public markets. He stated that the SEC should seek to increase the attractiveness of going public without reducing the availability of capital from private markets.

> "I have been vocal about my desire to enhance the ability of every American to participate in investment opportunities, including through the public markets. I also want American businesses to be able to raise the money they need to grow and create jobs."

- **Improved disclosures for investors:** Clayton indicated that the SEC has several initiatives underway to improve the disclosure available to investors. He noted that the SEC staff is making good progress on preparing rulemaking proposals for the Commission to implement recommendations issued in November 2016 on ways to improve disclosures required by Regulation S-K.[3]

- **Vigorous enforcement and examination programs:** Clayton indicated that the SEC's enforcement and examination programs would continue to pursue misbehavior at all levels. He placed a special emphasis on cybersecurity, noting that companies have a clear obligation to disclose material information about cyber events as well as cyber-related risks, an obligation he expects to be taken seriously. However, he expressed caution about the enforcement consequences to companies that suffer highly sophisticated cyber penetrations.

> "Being a victim of a cyber penetration is not, in itself, an excuse. But, I think we need to be cautious about punishing responsible companies who nevertheless are victims of sophisticated cyber penetrations. Said another way, the SEC needs to have a broad perspective and bring proportionality to this area [of cybersecurity] that affects not only investors, companies, and our markets, but our national security and our future."

- **Review of market structure:** Clayton stated that the SEC has extensively analyzed the equity market structure and should now take action. He also suggested that the SEC should study the transparency, efficiency and effectiveness of the fixed income market, noting that it will be increasingly attractive to the rising number of investors that are reaching retirement age.

- **Fiduciary duty of investment professionals:** Clayton noted the recent implementation of the Department of Labor (DOL) Fiduciary Rule and indicated his intent to work with DOL to seek clarity and consistency regarding the standards of conduct for investment advisers and broker-dealers in their interactions with retail investors. Clayton also reiterated his call for comments on this topic, originally issued in June.[4]

- **Investor education:** Clayton indicated that he will devote resources to improving the information and tools available to investors to help them protect themselves.

[2] For more information, see EY's "To the Point: SEC staff substantially expands scope of confidential review program for draft registration statements," 6 July 2017, www.ey.com/Publication/vwLUAssets/ey-to-the-point-2017/$FILE/ey-to-the-point.pdf.

[3] Regulation S-K contains non-financial disclosure requirements. "Report on the Modernization and Simplification of Regulation S-K," 23 November 2016, SEC website, www.sec.gov/files/sec-fast-act-report-2016.pdf, accessed July 2017.

[4] "Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers," 1 June 2017, SEC website, www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31, accessed July 2017.

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