ROPES & GRAY

ALERT

Asset Management

November 1, 2017

Q&A: What to Expect from the "New" SEC

David Tittsworth and Jeremiah Williams are Counsels in the Washington, D.C. office of Ropes & Gray. David served as President and CEO of the Investment Adviser Association for 18 years prior to joining Ropes in 2015. Before that, he worked in various positions on Capitol Hill, including as counsel to the House Energy and Commerce Committee. Before joining Ropes & Gray's D.C. office last year, Jeremiah served as Senior Counsel in the Division of Enforcement at the SEC in its Asset Management Unit.

Q: What is the current state of play at the SEC?

A: The big news is that Jay Clayton was sworn in as the 32nd Chairman of the SEC on May 4. Clayton has a very distinguished background as a partner at Sullivan & Cromwell for over two decades. Clayton joins two other Commissioners, Republican Michael Piwowar and Democrat Kara Stein, who were sworn in as Commissioners in August 2013. Piwowar and Stein are both former Senate staffers but they are pretty much polar opposites when it comes to key policy issues.

Q: What about the other two open seats at the SEC?

A: Under the Securities Exchange Act of 1934, the SEC is designed to function as an independent regulatory agency with a total of five commissioners. Earlier this year, President Trump nominated Hester Peirce (a Republican) and Robert Jackson (a Democrat) as SEC Commissioners. The Senate Banking Committee held a confirmation hearing for these nominees in late October, and we expect that the Senate will vote to confirm the nominations within the next few weeks. When that happens, it will be the first time that the SEC will operate with five commissioners since 2015 when Commissioners Gallagher and Aguilar left.

Q: It may seem like a basic question, but why is the SEC chairmanship so important?

A: The Chair hires all the key staff, serves on the Financial Stability Oversight Council, runs the day-to-day operations of the SEC with about 4,500 employees, and serves as the main contact with Capitol Hill, the White House, and with other regulators and policymakers. Most important, the Chairman sets the agenda for the agency. He or she has the power of the gavel to decide which issues are going to be considered and which will not.

Q: What observations do you have about Clayton's potential regulatory agenda for the asset management industry?

A: Chairman Clayton's agenda is beginning to take shape. He has hired all of his senior staff, which is a critical element to drafting and implementing any new regulations. In public speeches and congressional testimony, Clayton has explicitly indicated that he opposes wholesale changes to the Commission's fundamental regulatory approach and that he supports the SEC's three core missions: to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. He has stressed that regulatory actions can drive change and suggested steps that should be taken to reverse the decline in the number of publicly traded companies. He has stated that the SEC needs to evolve and use technology and innovation in ways that are going to improve regulatory efficiencies. He has emphasized that the SEC needs to look beyond just mere rule adoption and that it should review its rules retrospectively to make sure they are working as intended. And he said the SEC needs to coordinate with other regulatory players, including the CFTC, on derivatives issues. Specific issues that Chairman Clayton has discussed include cybersecurity, corporate governance, and standard-of-conduct rules for broker-dealers and coordinating those rules with the Department of Labor's controversial fiduciary rule.

Q: What are industry groups doing to influence Clayton's regulatory agenda?

A: The wide variety of associations and trade groups representing asset management firms are also trying to figure out what Chairman Clayton's agenda is and how they can help shape that agenda. Groups representing mutual funds, mutual fund directors, investment advisers, hedge funds, and private equity firms have all met with Clayton and submitted numerous regulatory proposals. The ICI, for example, has expressed support for a properly tailored derivatives rule. They've also suggested revisions to the liquidity rule that was adopted last year. The Investment Adviser Association has expressed support for a retrospective review of investment adviser rules. The Managed Funds Association, representing hedge funds, has asked the SEC to ensure data security and treatment of confidential information. The American Investment Council, which represents PE firms, has asked the SEC to abandon the business continuity/transition planning rule proposed last year and to revise the current pay-to-play rule. These examples are just the tip of the iceberg. These and other interest groups will continue to push for changes and it is certainly possible that some of those changes could end up on Chairman Clayton's regulatory agenda.

Q: What influence is the Trump administration having on the SEC?

A: President Trump has issued a number of executive orders that are clearly de regulatory. The SEC is an independent regulatory agency so it's really not technically bound to follow the executive orders. But we think it would be foolish to think that presidential nominees who run agencies like the SEC and CFTC are just going to ignore these presidential directives. In late October, the Treasury Department issued a report on asset management and insurance issues. The recommendations include sensible regulatory actions that can be considered and adopted by the SEC, such as such as revising and delaying the liquidity rule (including the rule's current bucketing requirements), considering adoption of an appropriate derivatives rule, adopting a plain vanilla ETF process, withdrawing the proposed business continuity and transition planning rule, modernizing the delivery of mutual fund shareholder reports, and encouraging the SEC to take a leading role with the FSB and IOSCO in international issues relating to the asset management profession, including discouraging the use of the term shadow banking in reference to asset management activities. The report also includes important recommendations that would require the CFTC to exempt firms that are already registered with the SEC and encourage harmonization of reporting requirements by the SEC, CFTC, and SROs. The report also recommends that the DOL should continue its examination of the fiduciary rule and that the SEC and DOL should work together to adopt consistent rules relating to standards of conduct for investment professionals to benefit all investors. Collectively, the Treasury recommendations are well-considered, moderate, and could form the basis for significant improvements in the regulation of asset management firms without diminishing investor protections. The recommendations do not require action by Congress and thus could be implemented through the APA rulemaking process by the SEC, CFTC, and other regulatory bodies. The Treasury Department should be applauded for its thoughtful and meaningful report. Obviously, the ball is now in the court of the SEC and other regulatory bodies.

Q: What are the prospects for potential legislation on Capitol Hill that would affect the SEC's regulatory agenda?

A: It's a tale of two houses. In June, the House passed the sweeping Financial Choice Act on a strict party-line vote. Essentially, this is the anti-Dodd-Frank Act. Among many other things, it would repeal the Volcker rule, repeal private equity SEC registration requirements, repeal the authority of the Financial Stability Oversight Council to designate nonbank systemically important financial institutions, and repeal the Department of Labor's controversial fiduciary rule. There's virtually no chance that the Senate is going to do anything similar. It is possible at some point that incremental legislation could gain bi partisan momentum in the Senate where 60 votes are required to get to a vote. But the bottom line is that, absent some external, unexpected event, we think it's highly unlikely that Congress will enact significant asset management legislation anytime soon.

Q: What is your assessment of Chairman Clayton's views on enforcement issues?

A: Chairman Clayton has a very different background from Mary Jo White, who came to the SEC in 2013 as a former prosecutor. But he has clearly stated his steadfast support to continue a strong and active enforcement program. His proposed 2018 budget will continue to devote 50% of the SEC's resources toward enforcement. He has made two appointments – Steven Peikin and Stephanie Avakian – as co-directors of the Division of Enforcement. Mr. Clayton appears to support a continuation of a robust enforcement program rather than any significant departure. However, in late October Mr. Peikin spoke about a distinct shift in priorities. He signaled that the SEC may be more selective and bring fewer cases rather than continue the "broken windows" approach of his predecessor. In any event, it will take time to see how his priorities differ in practice. There are literally hundreds of cases in the pipeline and it would be unwise to assume that there will be a dramatic change overnight.

Q: What about Mr. Clayton's views on inspection activities?

A: Chairman Clayton has expressed strong support for an effective inspection program. With respect to investment adviser examinations, Clayton has noted that the number of investment adviser investment company examinations will increase during the SEC's 2018 fiscal year. Increasing the examination rate for investment advisers is a priority for Chairman Clayton.

Q: How would you summarize the current state of play at the SEC?

A: Chairman Clayton's agenda is beginning to take shape, including regulations to enhance IPOs and other corporate governance issues, a focus on cybersecurity and retail investors, working with the Department of Labor on fiduciary regulations, and considering numerous issues raised by reports from the Department of Treasury, as well as considering proposals from numerous trade groups. While some of these measures may be considered deregulatory in their direction, we do not think it would be wise to expect an immediate, dramatic rollback of SEC regulations. Asset managers and other regulated entities need to continue to pay attention to their legal, regulatory and compliance obligations. We certainly will continue to pay close attention as developments occur in the coming weeks and months.