

SEC Commissioners Say More Regulation, Oversight Needed

Matthew P. Allen

February 2013

Troy

SEC commissioners called for a more regulations and oversight to protect investors from fraud and other dangers, reports Miller Canfield securities compliance and enforcement lawyer Matt Allen.

Allen attended the 42nd annual "The SEC Speaks" conference in Washington D.C. on February 22 and 23, 2013. The conference features SEC commissioners and division leaders addressing legal and business issues that affect securities markets, principals, and investors.

"The SEC Speaks" program acknowledged the importance of protecting private capital investors through Dodd-Frank rules and rulemaking for angel funding, private equity, and crowd funding rules under the JOBS Act. The policy rationale is that if the SEC doesn't work to keep these markets fair and efficient, new investors won't come forward with capital, and new inventions that have been the key to our nation's economic growth, such as automobiles, medical devices, technology devices, etc., will not find the funding necessary to come to fruition.

In her opening remarks, SEC Chairperson Elisse Walter discussed the importance of protecting entrepreneurs who need funding and the investors that provide it. She said the 2008 financial crisis requires a "significant regulatory response" to maximize stability of capital and securities markets and minimize moral hazard, which she indicated was the primary aim of the Dodd-Frank legislation and rulemaking.

Investment risk must be inherent to the business in which investors invest, not because of fraud or lack of appropriate access and disclosure, Walter said. She used Henry Ford as an example of how a risky business venture requires capital from sophisticated investors who are willing to take risks for the business in exchange for high returns, especially when banks and other traditional lenders are prohibited from doing so. It took Ford ten years and three corporate structures before structuring the Ford Motor Company as we know it today, she noted.

Ford Motor Co., like many startups back then and today, had a high potential of failure and a low potential for high returns. These risky but innovative ideas require access to sophisticated investment capital. Protecting these investors to facilitate the success of US innovators like Henry Ford is the job of securities and market regulators, Walter said.

Commissioner Luis Aguilar advocated for more robust market oversight by the SEC. Aguilar said the increasing number of trading exchanges, increased daily trading volume, and increasing reliance on high-speed, fully automatic trading has created more risk and higher risk of loss for investors. These factors will lead to unacceptable market failures, which will erode investor confidence and the price integrity of capital markets, he said.

Commissioner Tony Paredes called for more adequate disclosures, arguing that disclosure of too much non-material information may cause investors to concentrate on marginal information at the expense of more valuable, material information.

Commissioner Daniel Gallagher discussed the importance of the SEC's independence. He said the discretionary independence once accorded the SEC by the Securities Exchange Act of 1934 was removed by the Dodd-Frank Act, in which Congress gave the SEC more than 100 new mandates. Gallagher also said the Financial Stability Oversight

Continued

Council ("FSOC") hinders the independence and ability of agencies like the SEC to govern the industry and products unique to its expertise. He provided as an example FSOC's pressure to regulate money market funds, an industry within the exclusive expertise of the SEC.¹

Other highlights and priorities announced by the SEC for 2013 include:

- Crowd funding rules and '33 Act exemptions under the JOBS Act;
- Implementing Titles I-VII of the JOBS Act, and the Act's significance given the decline in the number of public reporting companies over the last decade;
- The February 21, 2013 publication of the 2013 investment adviser, investment company, and broker dealer Examination Priorities by the SEC Office of Compliance Inspections and Examinations ("OCIE");
- SEC examination and investigation priorities for registered investment advisers ("RIAs"), broker dealers, and the increasing dual registration and cross industry practices of RIAs, broker dealers, and their personnel;
- Updates from the SEC Office of the Chief Accountant about pre-filing opinions, the FASB Convergence Project, and the status of transitioning US filers from US GAAP to International Financial Reporting Standards, and when certain information must appear in the notes to the financial statements or in the management discussion and analysis section;
- The new eXtensible Business Reporting Language ("XBRL") reporting requirement and the interactive, structured data it provides to investors and analysts;
- The new SEC Risk Analysis and Surveillance Unit, Quantitative Analytics Unit, and Certified Examiner Training Program;
- The Office of Analytics and Research and the use of algorithms and other quantitative data and technologies to monitor markets and trading, including high frequency trading; this Office is an example of the SEC becoming less focused on hiring lawyers and more focused on hiring personnel with specific market and trading experience;
- Office of the Whistleblower and accompanying technology;
- Detecting and deterring insider trading and market manipulation;
- Proper IPO disclosures and share class and voting structures;
- SEC's Guidance on Economic Analysis regarding improved economic impact analyses of its proposed rules, and;
- Focus on SEC subpoena enforcement cases to combat untimely or incomplete document productions in response to SEC subpoenas.

The SEC continues to "hedge against disaster" with its dual efforts to minimize systemic market risk through prudential regulation, and provide more granular regulation at the investor level. Miller Canfield's securities lawyers can help you structure your funding or offering, and advise you on securities compliance, enforcement, and litigation risks and consequences.

For additional information on "The SEC Speaks" conference, please contact Allen at 248-267-3290 or allen@millercanfield.com.

Continued

¹ The views expressed by the individual SEC Commissioners at “The SEC Speaks” were not necessarily those of the SEC, and were not meant to reflect the position of the SEC.