U.S. Securities and Exchange Commission

Remarks at "The SEC Speaks in 2013"

by

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Thank you, Craig [Lewis], for your kind introduction. This is my second year addressing this conference as a Commissioner. Last year, I spoke as one of five Commissioners, while this year, as you well know, we're temporarily down one member. And so, I understand that the organizers are offering a 20% discount which you can collect after my remarks. Just kidding. The truth is that they asked all of us to give longer speeches, and since I am still the junior Commissioner, the others dumped their extra time on me. So, I hope you are ready for an hour long adventure.

Before I begin, let me remind you that as usual, my remarks today are my own and do not necessarily reflect the views of the Commission or my fellow Commissioners.

On a number of occasions since returning to the SEC as a Commissioner, I've spoken about the Commission's priorities, both in terms of what the Commission *is* doing and what it *should be* doing in order effectively to carry out its mandate to protect investors, ensure fair and efficient markets, and facilitate capital formation. Needless to say, the Commission does not operate in a vacuum, and for various reasons, it's not always easy to execute those priorities as we see fit. The constant stream of external influences on the Commission's work serves as a significant impediment to its ability to focus on the core mission, including the vital, basic "blocking and tackling" of securities regulation. Today, therefore, I'd like to talk about the Commission's origin and role as an expert, independent agency — as well as the challenges to that independence — in what has become in recent years a difficult environment for independent agencies.

As I'm sure all of you know, Congress created the SEC in the Securities Exchange Act of 1934. What some of you may not know, however, is that the Securities Act of 1933 originally tasked the Federal Trade Commission with administering the new federal securities laws. Indeed, the FTC was the initial choice of many, including President Franklin Roosevelt, to administer the Exchange Act as well.[1] Ultimately, however, a consensus emerged that the difficult task of administering the federal securities laws required the creation of a new independent, bipartisan agency with a high level of technical expertise in securities matters that could focus exclusively on the nation's capital markets. For example, during consideration of the House version of the legislation that would ultimately become the Exchange Act,

Representative Charles Wolverton cited the "high degree of technical skill and knowledge," that would be necessary to administer the new federal securities laws in his support for the creation of a five-member, expert Commission to take over the administration of those new laws.[2] Similarly, during consideration of the corresponding Senate bill, Senator Duncan Fletcher explained the belief among "[m]any people, Members of Congress and others . . . that a special commission ought to be provided to administer the measure because the provisions are largely technical, and we ought to have men experienced in business of the kind involved."[3]

The final version of the Exchange Act that emerged from Congress in the summer of 1934 provided the newly-established Commission with a broad mix of regulatory and quasi-judicial authority to carry out the legislative policies set forth in the Securities Act and the Exchange Act. The movement toward the establishment of expert, independent agencies represented a major shift in the regulatory paradigm, and it wasn't long before this model was challenged. A year after Congress created the SEC, the Supreme Court took up the issue of independent agencies in the case of *Humphrey's Executor v. United States*, which arose from President Roosevelt's attempt to remove William Humphrey from his position as an FTC Commissioner. Much to the chagrin of the President, the Court ruled that as "an administrative body created by Congress to carry into effect legislative policies," an independent agency such as the FTC "cannot in any proper sense be characterized as an arm or an eye of the executive. Its duties are performed without executive leave and, in the contemplation of the statute, must be free from executive control."[4] Most recently, in its 2010 decision in *Free Enterprise Fund v. PCAOB*, the Supreme Court implicitly referenced the Commission's independence, proceeding on the understanding that SEC Commissioners "cannot themselves be removed by the President except under the *Humphrey's Executor* standard of inefficiency, neglect of duty, or malfeasance in office."[5] This stands in contrast to, for example, Cabinet secretaries, who, while subject to Senate confirmation, serve at the pleasure of the President.

Having established the SEC as an expert, independent agency with the authority to administer the federal securities laws, Congress has traditionally provided the Commission with considerable flexibility to exercise that expertise and authority. Historically, Congress has avoided imposing minutely detailed mandates on the Commission. Instead, Congress has, in conjunction with past grants of authority to the SEC, largely left it to the Commission to study issues and formulate rules which the Commission deemed in its discretion to be "in the public interest or for the protection of investors," a phrase that appears time and again in our securities laws.[6] As President Roosevelt himself remarked upon signing the Investment Company Act and Investment Advisers Act into law in 1940, "[E]fficient regulation in technical fields such as this requires an administering agency which has been given flexible powers[.]"[7]

For nearly eighty years, the Commission, like other independent agencies, has brought its expertise and judgment to bear in fulfilling the legislative mandates established by Congress in the federal securities laws. Yet, in today's post-financial crisis, post-Dodd-Frank regulatory environment, the Commission is faced with a variety of challenges that carry with them the potential to erode its independence. The Commission must remain alert to these challenges and must respond when appropriate in order to preserve its ability to act independently in fulfilling its core mission. My concerns here do

not derive from ideology or a desire to perpetuate seemingly age old agency turf wars. Instead, this is about the need to preserve a long-standing regulatory model that eschews a one-size-fits-all approach in favor of allowing expert, independent agencies to craft rules that, when necessary, are appropriately tailored to the specific entities and products they regulate.

And then came Dodd-Frank. I worry about the limits placed on the Commission's ability independently to apply its expertise and judgment under the paradigm established by the Dodd-Frank Act. The Act contains approximately 400 specific mandates to be implemented through agency rulemaking, around 100 of which apply directly to the SEC. Many of these mandates are highly prescriptive, and instead of directing the Commission to regulate in an area after studying the relevant issues, compiling data, and determining what, if any, regulatory action may be appropriate, they require the Commission to issue strictly prescribed and often highly technical rules under short deadlines. Unfortunately, although the Commission always has some degree of discretion when implementing a Congressional mandate, these more prescriptive rules limit the Commission's flexibility in the rulemaking process while occupying time and resources that could be better spent fulfilling the Commission's other important responsibilities. If one of the duties of an independent agency is to work proactively with Congress to ensure that statutes do not impose unnecessary or inappropriate mandates, then on that front the Commission unfortunately came up short with respect to many Dodd-Frank mandates.

Ideally, when Congress provides the SEC with statutory authority to draft and implement rules in a new area, it will allow the Commission the time and flexibility necessary to study the issues involved and formulate smart regulation that reflects a complete understanding of the underlying data, including the costs and benefits associated with regulatory action. This is, after all, how the Commission was intended to operate when it was established nearly eighty years ago. In fact, I believe it is the Commission's duty as an expert, independent agency to continue to employ this data-driven approach as best it can even in the face of prescriptive mandates from Congress.

Although the Commission continues to stare down an overflowing plate of Dodd-Frank mandates in addition to its other responsibilities, as an expert, independent agency, the Commission must not allow itself to assume a secondary role in the regulation of matters squarely within its jurisdiction and core competencies. This, I'm afraid, is exactly the role that the Commission has taken thus far with respect to critical initiatives, including the Volcker Rule.

Pursuant to Section 619 of Dodd-Frank, the three Federal banking agencies, the SEC, and the CFTC must together adopt regulations to implement the Volcker Rule's two prohibitions on banking entities and their affiliates: its prohibition on engaging in proprietary trading and its prohibition on sponsoring or investing in "covered funds" such as hedge funds or private equity funds. Unfortunately, there is little doubt that notwithstanding the valiant efforts of the SEC staff, the Commission for too long has taken a back seat to the banking regulators in this rulemaking process. As I have said in the past, despite the Rule's ostensible application to banking entities, the Rule is actually focused on the *conduct* to be regulated, not the *entities* that engage in this activity. There is no question that the specific trading, hedging, and investing activities to be regulated under the Rule fall firmly within the Commission's core competencies, as they deal directly with SEC

registrants and registration requirements. It makes little sense, therefore, for the Commission to defer to the banking regulators in this area when for decades it has regulated securities market-making in order to facilitate liquidity and promote the efficient allocation of capital.

The implementing rulemaking for the Volcker Rule was proposed in October 2011. Almost a year and a half — and over 18,000 comment letters — later, the Volcker Rule remains at the proposal stage. Indeed, it appears that the proposal's broad definitions of statutory terms have taken a bad situation and made it worse. Commission staff continue to engage in discussions with the bank regulators and the CFTC regarding the many concerns raised in those 18,000-plus comment letters. For this rule to get done and get done properly, the SEC must take a leadership role. In fact, I believe it is our duty as the independent financial regulator with primary authority over, and expertise in, the activities to be regulated to ensure that the final Rule meets the aims of Congress without destroying critically important market activity that the Rule explicitly intends not to eliminate. Moreover, in accordance with its core mission, it is the Commission's responsibility to balance the bank regulators' focus on safety and soundness and Dodd-Frank's overarching focus on managing systemic risk with legitimate considerations of investor protection and the maintenance of vibrant markets.

This brings me to the elephant in the room: FSOC. FSOC was created, in part, to respond to the realization during the financial crisis that regulatory balkanization had resulted in a lack of communication and information-sharing among financial services regulators, which undoubtedly led to poor policy decisions during the crisis. None of us who lived through the crisis on the ground floor would argue against improvements to the regulatory structure that would facilitate coordination and information-sharing among regulators. However, with FSOC the threats to the Commission's independence move from the theoretical to the immediate, for already in its short existence, this new body has directly challenged the Commission's regulatory independence. It is also where just one member of the Commission, the Chairman, can defend that independence. Pursuant to the provisions of Dodd-Frank establishing FSOC, the group is composed not of agencies, but the individual heads of agencies, acting *ex officio*.

As I have said in the past, the structure of FSOC is particularly troubling for an independent agency like the SEC. While the Secretary of the Treasury and the heads of the FHFA and the CFPB may speak on behalf of their agencies — not to mention the President that appointed them — the same cannot be said of the Chairman of the SEC. To preserve its independence, Congress created the SEC as a bipartisan, five-member Commission and gave each Commissioner — including the Chairman — only one vote. This means that the Chairman has no statutory authority to represent or bind the Commission through his or her participation on FSOC. Yet as a voting member of FSOC, the Chairman of the SEC does have a say in authorizing FSOC to take certain actions that may affect — and indeed have already affected — markets or entities that the Commission regulates. While one might expect that the Chairman of the SEC would always represent the views of the Commission as a whole, there is no formal oversight mechanism available to the Commission to check the Chairman's participation on FSOC. Moreover, although the Commission's bipartisan structure insulates it from undue political influence, FSOC's structure does not. On the contrary, FSOC is composed of individuals who are heads of their agencies — typically making them members of the President's political party — and led by a

Cabinet official who is removable by the President at will. These factors, among others, make FSOC particularly susceptible to political influence which, in turn, can be — and has been — exerted on the agencies led by FSOC's members.

To further complicate matters, FSOC operates under a different mandate than the SEC, having been established by Congress with a broad mandate to identify systemic risks and emerging threats to the country's financial stability. Putting aside the fact that FSOC's designation of certain firms as "systemically important" likely institutionalizes the idea of "too big to fail," FSOC's core mission is to ensure the safety and soundness of the U.S. financial system — not surprising given that a significant plurality of FSOC is composed of the heads of bank regulators. While this mission is of unquestionable importance, so, too is the distinct mission of the SEC. To be sure, proper oversight of our capital markets should positively impact the safety and soundness of our financial system. Nevertheless, the SEC is not by statute a safety and soundness regulator. In fact, the markets we regulate are inherently risky, and with good reason. By putting money at risk, investors allocate capital in a manner that spurs economic growth in the hopes of a much higher return on their investments than they could obtain from lower-risk, lower-return investments, such as bank accounts. The SEC seeks to protect these investors from fraud and to ensure that the markets in which they put their capital to work are fair and efficient. Our mission is not, and should not be, to make these markets risk-free, nor is it to preserve the existence of any particular firm or firms. Capital markets regulators and bank regulators have drastically different missions and oversee fundamentally different markets and market participants. And, importantly for me and all of those who appreciate and advocate for free markets, we must keep a healthy distance between capital markets regulation, which rightfully assumes no taxpayer safety nets, and bank regulation.

It is not difficult to see the potential tension between the SEC and FSOC missions and the resulting threat to the Commission's ability to function independently. As the old adage goes: "No one can serve two masters." When the Chairman of the SEC faces this tension, which of these two potentially competing mandates does he or she honor?

Nor is FSOC merely an advisory body without teeth. To carry out its mandate, Congress provided FSOC with extraordinary powers for an inter-agency council. For example, FSOC has the authority to designate a nonbank financial company as "systemically important," and to subject these companies to prudential supervision by the Fed. FSOC may also designate a financial market utility or a payment, clearing, or settlement activity as "systemically important," and direct the Fed, in consultation with the relevant supervisory agencies and FSOC itself, to prescribe risk management standards. To the extent that these "systemically important" utilities or activities are conducted by firms for which the SEC or CFTC is the primary regulator, Dodd-Frank provides "special procedures" pursuant to which the Fed may, if it determines that the risk management standards set by the SEC or the CFTC are "insufficient," impose its own standards. That authority is not simply a threat to the Commission's independence — if exercised, it would be an outright annexation.

FSOC also has the authority to recommend that a primary financial regulator, such as the SEC, apply new or heightened standards and safeguards for systemically significant financial activities or practices. In this regard, FSOC

has been busy in recent months prodding the Commission on money market fund reforms, including through the release of proposed reform recommendations last November.

I won't recount the history that led to FSOC's involvement in the regulation of money market funds, an area which unquestionably falls within the core expertise and regulatory jurisdiction of the SEC. But I will emphasize that my colleagues and I have made it clear that, having now been provided with the rigorous study and economic analysis on money market funds that a bipartisan majority of the Commission asked for from the start, we fully expect the Commission to move forward with a rule proposal shortly. Why, then, is FSOC still involved in the process? FSOC was established in part to promote coordination, collaboration, and information-sharing among its member agencies. It is immensely troubling then to think of the FSOC as an institutionalized mechanism for one set of regulators to pressure another in the latter agency's field of expertise — yet that is exactly what is happening.

Moving on from the threats posed to the Commission's independence by Congressional mandates and FSOC intervention, there are other, more mainstream, jurisdictional incursions the Commission must monitor and manage. For example, in December 2012, the Fed, acting pursuant to Dodd-Frank authority, issued proposed regulations to apply U.S. capital, liquidity, and other prudential standards to the U.S. operations of foreign bank organizations with total global consolidated assets of at least $50 billion.[8] These rules, if adopted in their current form, would require such organizations to create an intermediate holding company that would house all of their U.S. bank and nonbank subsidiaries.

The Fed proposal would affect SEC registrants as the new holding company capital rules would treat assets held by broker-dealer subsidiaries differently than they are treated in the SEC capital rules because of the proposed leverage standard that would apply to foreign bank organizations. Specifically, a U.S. broker-dealer subsidiary of a foreign bank organization could be required indirectly to hold more capital than would be necessary to satisfy the SEC's net capital rule to maintain the same positions.

The regulation of broker-dealers is at the heart of the Exchange Act and, as such, has been under the Commission's regulatory purview for nearly eight decades. Using the expertise it has developed over this period, the Commission has designed capital requirements under Rule 15c3-1 that are tailored to the operations of broker-dealers and the industry in which they operate. Here, it is crucial to understand the differing theories that underlie broker-dealer and bank capital requirements. The Commission's capital rules are meant to deal with failure, in that they are designed to ensure that when a broker-dealer fails, it has net liquid assets in excess of all non-subordinated liabilities so that the firm can be self-liquidated in an orderly manner and satisfy all creditors, particularly its customers. On the other hand, bank capital standards are not designed to require a bank to maintain sufficient net liquid assets to satisfy all creditors. Instead, banks have access to federal liquidity facilities that can be used as a funding source in the event that the bank cannot find private funding. These facilities allow the bank to be liquidated in a more orderly manner in the case of a failure. And, if the bank is "too big to fail," the facilities can operate as a tax payer-funded life support system. Accordingly, it will be very important for the Fed and the Commission to coordinate carefully as this rule proposal is considered to ensure that legitimate goals can be advanced without

undermining SEC oversight.

This Fed rulemaking comes on the heels of the misguided repeal in Dodd-Frank of the Commission's Supervised Investment Bank Holding Company, or SIBHC, program. This little-known program, which the Commission implemented under the authority of Exchange Act Section 17(i), should have been expanded in Dodd-Frank to allow the SEC to better oversee non-systemically important broker-dealer holding companies. Instead, Dodd-Frank eliminated Exchange Act Section 17(i), and replaced it with a new Fed program.

On a final note, the Commission must also be mindful of the effect that international regulatory bodies, even those like IOSCO and the FSB in which the Commission is a participant, can have on the Commission's prerogatives as an expert, independent agency. Many of these organizations were formed in large part to foster cooperation, information-sharing, and coordination among financial regulators in different jurisdictions. However, we now often see from these groups one-size-fits-all "recommendations," some of which run contrary to the Commission's existing regulations or address the substance of specific issues pending before the Commission. I believe that the Commission must remain an active, productive member of these groups, but we must ensure that policymaking remains in the hands of domestic regulators acting with the requisite independence.

Thank you all for coming to this year's SEC Speaks, and I look forward to seeing you again next February.

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1 *See* Ralph F. De Bedts, The New Deal's SEC, 73 (1964).

2 House Consideration, Amendment, and Passage of H.R. 9323, at 7865 (May 1, 1934), *in* 4 Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (J.S. Ellenberger & Ellen P. Mahar comps.) (2001), *available at* http://heinonline.org.

3 Senate Consideration and Amendment of S. 3420, at 8404 (May 9, 1934), *in* 4 Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (J.S. Ellenberger & Ellen P. Mahar comps.) (2001), *available at* http://heinonline.org.

4 295 U.S. 602, 628 (1935).

5 130 S.Ct. 3138, 3148—49 (2010) (internal quotations omitted).

6 *See* Joel Seligman, The Transformation of Wall Street, 99—100 (3d ed. 2003) (quoting the Exchange Act).

7 Franklin D. Roosevelt, Statement on Signing Two Statutes to Protect Investors (Aug. 23, 1940). Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*, http://www.presidency.ucsb.edu/?pid=15993.

8 *See*, *e.g.*, Board of Governors of the Federal Reserve System 2012 Banking and Consumer Regulatory Policy Press Release, Dec. 14, 2012, *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20121214a.htm; Donna Borak, *Fed Looks to Seize Foreign Broker-Dealer Supervision from SEC*, American Banker, Jan. 16, 2013, *available at* http://www.americanbanker.com/issues/178_11/fed-looks-to-seize-foreign-broker-dealer-supervision-from-sec-1055871-1.html.

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