

Speech

Investor-Focused, Nimble and Vigorous Enforcement at the SEC



Chairman Jay Clayton

Sept. 17, 2020

Perspectives on Oversight, Management and Performance

Introduction

Good afternoon and welcome to a discussion of how we oversee, manage and measure the performance of the SEC's Enforcement program. I will begin with some important acknowledgements.

First, a big thank you to Jill Fisch for her kind introduction. Turning to the Penn community more broadly, a thank you to the Institute for Law & Economics for being our host. Your programming is second to none in the way it synthesizes the analysis of laws, markets and, importantly, outcomes. The ILE is just one of many fine examples of what I think is Penn's greatest strength – pursuing rigorous academic study always with an eye toward societal impact and improvement; just as Penn's founder, Ben Franklin, would have wanted it.

Second, a thank you to our four panelists and a specific shout out to Steve Cutler, who I first met fifteen or so years ago when he was the SEC's Director of Enforcement. When I agreed to take on the role of SEC Chairman, the question of how best to oversee the Enforcement Division became front of mind. While I was fortunate to have more litigation and investigative experience than you would expect from a corporate lawyer, I had not managed an enforcement program of any size, much yet one of over 1400 professionals distributed across 12 offices. Steve set me straight. Speaking my language, he noted that the Division was an established, well-functioning subsidiary with products (i.e., cases) that had a long production cycle and assets (i.e., people) that were fixed and valuable — in other words, attorneys who enjoyed their jobs, knew each other well and were committed to the mission.

Third, a thank you to Stephanie Avakian, who you will hear from in a few moments.^[1] Stephanie was the Acting Director of Enforcement when I arrived. I had not previously met her. Many people expressed interest in the Director position. Well, to make a long story short, it was quickly apparent to me that Steve Cutler's description of the Division was correct and, importantly, the well-functioning

subsidiary already had an effective and well-respected leader in Stephanie. Here, I'll share an anecdote. A friend who knew Stephanie professionally said to me, "do not interview her if you don't want to hire her." That was unassailably correct advice, but, as a practical matter, unnecessary because, in reality, it was the other way around. Stephanie was interviewing me, on behalf of herself and the career staff of the Division. And, Stephanie, I thank you and your colleagues, for continuing your invaluable service and, in a sense, hiring me.

With that context, I will provide some reflections on the oversight, management and performance of the Enforcement Division and highlight a few examples where the work of the Division has yielded significant, long-term benefits to U.S. investors, including shaping our regulatory agenda and informing our rulemaking.

Establish Broad Principles for Both Action and Evaluation

In managing an organization, there are some fundamental questions. Two of the most important are: (1) What are we trying to accomplish?, and (2) How are we going to measure our performance? Starting with the second question, while the Enforcement Division's traditional statistics were – and continue to be – impressive,^[2] it is my view that we should take care not to fall into the mode of managing to the available data. Or, said another way, as in any endeavor, we should guard against allowing the data that is readily available to drive objectives, rather than measures that reflect our core principles. Ultimately, objectives and related metrics should be grounded in an organization's foundational principles.

So, where to start when defining principles? We started by asking, how would a long-term, retail investor want us to allocate our resources? With that lens, we settled on: (1) getting harmed retail investors their money back as promptly as practicable; (2) pursuing matters that will have a lasting, positive impact for investors broadly – e.g., deterring or eliminating widespread inappropriate practices; and (3) instilling confidence in the integrity and fairness of our markets. In each case, with an eye toward our 50 million household-strong retail investor base.

I am pleased to say – through the leadership of Stephanie, Steve Peikin and many of their colleagues – these principles have shaped Division objectives and, to the extent practicable, our performance metrics to the benefit of investors.^[3]

Execution – Establish an Environment of Deference, Cooperation and Support

Another fundamental managerial question for organizations is method of execution. Here, I will start by returning to the observation that the Enforcement Division is a people-driven organization – akin to a high-end professional services business.

In my experience, well-functioning professional services organizations have both (1) talented, experienced, and diverse personnel with strong character, as well as a commitment to each other and to a shared mission and (2) an environment where those professionals have a combination of guidance, freedom, and support that enables them to take action and maximize their effectiveness.

Our front line enforcement personnel, by necessity, make tens of thousands of judgments each year. They need to know those judgments will be supported and, if they reach out for advice, it will be freely given and mission-oriented. I committed to Stephanie and Steve that I would defer to, and support

them on, how best to promote that type of culture, and they succeeded beyond any reasonable expectation.

Impactful Initiatives

Turning to some specifics in the area of execution, I will note just a few of the Enforcement Division's initiatives and how their work has led to real, lasting impacts for Main Street investors.

First, I want to highlight the work of the Retail Strategy Task Force,^[4] including our Teachers and Veterans Initiatives,^[5] and our Share Class Selection Disclosure Initiative.^[6] One of the questions I always encourage Main Street investors to ask is, “how much of my money is going to work for me, and how much is being used to pay fees and expenses”? Just think for a moment about the cost to a single investor of paying an extra 150 basis points in fees over twenty-five (25) years on \$100,000 invested in a retirement account.^[7] By one reporter's account, some back of the envelope math gives a difference of over \$100,000 in lost gains over that time period for that single investor.^[8] Time and again, our teams in our Office of Compliance Inspections and Examinations and our Enforcement Division have worked hard to save investors from paying fees that they did not know about and should not have been charged. For example, our Share Class Selection Disclosure Initiative alone will result in nearly \$140 million going back to investors, and it can be expected to save investors that amount many times over going forward.^[9]

Second, I am proud of our work in the area of ICOs. To call the ICO activity of late 2016 and 2017 a mess would be kind. I look back on that time as a stark, present day reminder that the behavior identified by the Pecora Commission in the early 1930s — in other words, the combination of fraud, speculation and widespread harm that drove the enactment of the Securities Act and the Exchange Act — can easily return in the absence of a culture of compliance and regulatory vigilance. One study has estimated that the amount raised in token offerings was \$7 billion in 2017 and nearly \$20 billion in 2018, and that it dropped to \$4.1 billion in the first ten months of 2019.^[10] Another study estimated that as of mid-2018, 86% of the prior year's leading ICOs were trading below their offering price, with nearly a third of those ICOs having lost substantially all their value.^[11] Apparently at the time, intoxicated or distracted by an admittedly powerful technology, many market participants — both investors and, much more concerning, certain market professionals — accepted form over substance and pursued profit over responsibility.

The Commission and the Enforcement Division responded quickly, including through issuing an investigative report confirming the application of the securities laws to the use of blockchain or distributed ledger technology to facilitate capital raising and to offers and sales of digital assets that are securities,^[12] followed by the creation of the Cyber Unit.^[13] Through a series of measured yet timely actions, the Enforcement Division, working closely with the Division of Corporation Finance, the Division of Investment Management and the Division of Trading and Markets, restored order, while leaving room for distributed ledger and other technologies to drive cost savings and innovation. This would not have been possible but for a culture that supports proactive decision-making and encourages principles-based flexibility. Or as I like to say, being nimble.

Third, and more recently, the Division again demonstrated its nimble nature in response to the effects of COVID-19. Our various Divisions and Offices took an array of prompt, investor- and market function-oriented actions,^[14] and the Enforcement Division was no exception. The Division's actions included trading suspensions for three dozen companies. In these cases, immediate action was necessary in light of questions regarding the accuracy and adequacy of information in the marketplace. In a number

of these circumstances, the Division followed with enforcement actions against issuers and individuals allegedly engaged in fraud based on COVID-19-related claims, such as preferred access to caches of personal protective equipment and the development of effective COVID-19 tests. Stephanie and Steve also released a statement reminding market participants of the importance of maintaining market integrity and following corporate controls and procedures, especially during times such as these.^[15] Good corporate hygiene cannot be overstated, nor can the importance of related controls designed to prevent not only insider trading, but also the appearance of impropriety or misalignment of interests. Just this week I sent Chairman Brad Sherman and Ranking Member Bill Huizenga of the House Financial Services Committee's Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets a letter at Chairman Sherman's request, in which I discussed some specific measures that public companies and their insiders should consider to promote compliance, market integrity and investor confidence, including through a demonstrated commitment to good corporate governance.

As I mentioned at the outset, the impact of the work in these areas and the many other initiatives is not readily apparent in traditional metrics such as number of actions and total monetary relief. Ironically, the faster and more effectively we act, the lower some of these numbers should be. That is one reason, in the area of metrics, I am generally most interested in the combination of money returned to investors (i.e., harm remedied) and money saved by investors (i.e., harm prevented).

A final point on initiatives. We require our registrants to disclose both the good and the bad news and, in that vein, it is appropriate for me to note that not every initiative has been as successful as I would like. Early in my tenure, I took up the personal initiative of focusing on the victims of the R. Allen Stanford fraud. These Main Street investors were defrauded brazenly, in circumstances with multiple indicia of regulatory and institutional protection. Yet, over a decade later, recoveries have been virtually non-existent and lawsuits drag on. I recognize that recoveries have been slowed by the international nature of the fraud – as I often have said, once money leaves our jurisdiction it is very hard to get it back^[16] – as well as the complexity of the claims process and other legal proceedings. But by any measure that is way too little and way too long. It is my sincere hope that we both continue to work on behalf of these victims to return as much of their defrauded money as possible and, more generally, evaluate our oversight, inspection and recovery efforts to bolster our ability to combat wrongdoing and act quickly to return funds to harmed investors.^[17]

Integration of Enforcement with Our Policy Divisions

The last execution-related matter I will discuss involves the integration of the Enforcement program into the work of our policy Divisions and Offices. Our markets are ever changing, and the financial markets of today are substantially different from those of the early 2000s. This dynamic requires us to retrospectively review and update the implementation of our regulatory framework. Our policy Divisions and Offices have been extremely busy in this regard. During my tenure as Chairman, these Divisions and Offices have advanced over 100 proposed and final rules.^[18] Enforcement has been involved in — and improved — many of the key investor-protection initiatives.

For example, with the interests of Main Street investors front of mind, we adopted Regulation Best Interest and Form CRS, which established (1) a new, heightened standard of conduct for broker-dealers when dealing with retail customers and (2) an investor-oriented uniform disclosure form for broker-dealers and investment advisers.^[19] The views and experience of Enforcement played an important role in these groundbreaking developments.

In the over-the-counter (OTC) market, where the majority of enforcement cases have involved delinquent filings, the Commission adopted amendments to Rule 15c2-11 to facilitate more current information from OTC issuers and to better protect investors from fraudulent and manipulative schemes using OTC issuers with stale information,[20] again with substantial input from Enforcement. [21]

Soon we will consider amendments to our whistleblower rules designed to make the program more efficient and effective. The program has already benefitted greatly from Stephanie's guidance and I expect the program will continue to do so as we move forward.

The Work of the Commission Continues; Exemplary Leadership is Critical

Human nature being what it is, there is still, as there will always be, work to be done. When I turn over the leadership of the Commission, my goal for the Enforcement Division is that it continues to bring meaningful cases that have a substantial impact on investors and the integrity of our markets.

I am grateful to my predecessor, Chair Mary Jo White, for providing us with that strong, well-functioning, and professional subsidiary that I referenced at the outset. Stephanie and Steve built on this foundation, and the achievements of the Enforcement Division have been impactful and long lasting because of their exemplary leadership. Only leaders with such skills, experiences and steadfast dedication to their staff — with the added bonus of competitive drive and commitment to continued improvement — could have achieved such impressive and meaningful results for investors, particularly in the face of judicial limitations on our authority, a government shutdown and a pandemic.[22]

I will not dwell on those challenges other than to return to the issue of metrics and note that one of the most reliable measures of performance is “how did you handle yourself, and how did you perform, in the face of adversity?” On this metric Steph and Steve, and the Enforcement Division, scored a 12 on a scale of 1 to 10.

I will close with some advice that I hope has similar value to the advice I received almost four years ago: if and when Stephanie departs, I encourage my successor to seek out a Director who will lead, as Stephanie and Steve did for us, by example and through that powerful combination of deference, cooperation and support.

And, with that, I will turn it over to our Director of Enforcement, Stephanie Avakian.

[1] My views are my own, Stephanie's views are hers.

[2] During my time as Chairman, the Enforcement Division under Stephanie and Steve's leadership has brought over 2,500 enforcement actions, obtained over \$11 billion in disgorgement and penalties, and returned over \$3 billion to harmed investors.

[3] See U.S. Sec. & Exch. Comm'n, Div. of Enforcement, Annual Reports for Fiscal Years 2017, 2018, 2019, *available at* <https://www.sec.gov/files/enforcement-annual-report-2017.pdf>; <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>; <https://www.sec.gov/files/enforcement-annual-report-2019.pdf>.

[4] See <https://www.sec.gov/news/press-release/2017-176>.

[5] See <https://www.sec.gov/news/press-release/2019-85>.

[6] See <https://www.sec.gov/news/press-release/2019-28>; <https://www.sec.gov/news/press-release/2019-200>; <https://www.sec.gov/news/press-release/2020-90>.

[7] See <https://www.wsj.com/articles/teachers-pay-high-fees-for-retirement-funds-unions-are-partly-to-blame-11576684664>.

[8] *Id.*

[9] See <https://www.sec.gov/news/press-release/2020-90>.

[10] See https://www.pwc.com/ee/et/publications/pub/Strategy&_ICO_STO_Study_Version_Spring_2020.pdf.

[11] See [https://www.ey.com/Publication/vwLUAssets/ey-study-ico-research/\\$FILE/ey-study-ico-research.pdf](https://www.ey.com/Publication/vwLUAssets/ey-study-ico-research/$FILE/ey-study-ico-research.pdf).

[12] See <https://www.sec.gov/news/press-release/2017-131>.

[13] See <https://www.sec.gov/news/press-release/2017-176>.

[14] See <https://www.sec.gov/sec-coronavirus-covid-19-response> for a discussion of the Commission's efforts in response to the effects of COVID-19.

[15] See <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>.

[16] See <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>.

[17] Under Stephanie and Steve's leadership, our collection efforts have improved, and I have asked staff to examine the claims, collection and distributions processes more generally, including the use of receivers and other third parties, to make our remedial efforts more effective.

[18] Because transparency is central to the effectiveness of an administrative agency, we take great care at the Commission to provide insight to investors, issuers, other market participants, Congress, fellow financial regulators and our staff regarding the Commission's rulemaking activities and priorities. One way we do this is through the semi-annual publication of the Regulatory Flexibility Agenda, which includes rulemakings expected to be accomplished in the near-term (one year) and in the long-term (more than one year). During my tenure, in addition to long-term and other rulemakings, we advanced 23 rulemakings in the 2018 near-term portion of the agenda by the end of that calendar year, or 88% of the items; 35 rulemakings in the 2019 near-term agenda, or nearly 90% of the items; and 35 items to date in the 2020 agenda, or 73% of the items - with more to come this year.

[19] See <https://www.sec.gov/news/press-release/2019-89>. Along with Regulation Best Interest and Form CRS, the Commission also issued related interpretations collectively addressing the quality and transparency of retail investors' relationships with broker-dealers and investment advisers.

[20] See <https://www.sec.gov/news/press-release/2020-212>. I have also directed the staff to evaluate the risks associated with certain broker-dealer activity in connection with omnibus accounts, particularly transactions in low-priced securities with offshore beneficiaries.

[21] And as another example, the Commission, with regular input from the Division of Enforcement, has been working towards the continued goal of implementing a secure Consolidated Audit Trail, which will provide important transparency to our equity and options markets. The implementation of the CAT has been difficult due to a variety of factors, including its initial design and vendor challenges. I am pleased to say that the CAT is now on a much better track and the Commission recently proposed amendments that are intended to ensure a more secure CAT that will operate without the need for sensitive personally identifiable information. See <https://www.sec.gov/news/public-statement/clayton-kimmel-redfearn-nms-cat-2020-08-21>.

[22] See, e.g., *Kokesh v. SEC*, 137 S. Ct. 1635 (2017); *Lucia v. SEC*, 138 S. Ct. 2044 (2018).