Remarks to the SEC Investor Advisory Committee

Chairman Jay Clayton

March 28, 2019

Thank you, Anne (Sheehan). Good morning everyone. It's good to see everyone again, particularly as the last time we all met in person was in December of last year. I was glad to be able to participate with Commissioner Roisman on a call with members of the Committee last month, where among other things we talked about human capital disclosures and proxy plumbing. My prepared remarks for that call—as well as Commissioner Roisman's—are available on our website.

Turning to the agenda for today, I look forward to the discussion on the stock exchange regulatory structure, which is an important topic for the Commission. I am also pleased that the Committee will revisit the discussion regarding disclosures on human capital. Finally, I look forward to the discussion on investment research and potential regulatory implications. Before going into detail, I note that my thoughts are my own and do not necessarily reflect the views of my fellow Commissioners or the SEC staff.

Stock Exchanges: Investor Protection Under the Modern Exchange Regulatory Structure

Earlier this month, I, together with our Director of the Division of Trading and Markets, Brett Redfearn, spoke at length about equity market structure at an event at Fordham University. I won't repeat those remarks, but suffice it to say that market structure is a topic that is very important to me and the staff. Our markets have evolved substantially over the last ten years, driven by increasingly advanced technologies and complex practices. We need to make sure our regulatory framework reflects the markets of today and is achieving its goals.

Last year, I was pleased that the Commission adopted rules providing for increased transparency of order routing practices, rules providing for operational disclosures by alternative trading systems ("ATSs") trading national market system ("NMS") stocks, and a transaction fee pilot program. The Division of Trading and Markets also held roundtables on the market structure for thinly-traded securities, regulatory approaches to combating retail fraud, and market data and market access. In my speech last month, I highlighted a few initiatives arising out of those roundtables that the staff is pursuing going forward. And on today's topic of the current exchange regulatory structure, I look forward to hearing what I hope will be an informative, balanced and constructive discussion. Let me emphasize those words—informative, balanced and constructive. This Committee's purpose is to *advise and consult* with the Commission on: (i) regulatory priorities of the Commission; (ii) issues relating to the regulation of securities products, trading strategies, and fee structures, and the effectiveness of disclosure; (iii) initiatives to protect investor interest; and (iv) initiatives to promote investor confidence and the integrity of the securities marketplace. In this regard, I am pleased to see the topics on today's agenda as they are front of mind for many of us at the Commission.

Disclosures on Human Capital

During the February 6 Committee call, I discussed my views regarding disclosures on human capital; today, I will summarize those remarks and emphasize a few points.

I look forward to hearing more about today's recommendation from the Investor as Owner subcommittee. As I mentioned previously, I believe the Commission's disclosure requirements and disclosure guidance must be rooted in the principles of: (1) materiality; (2) comparability; (3) flexibility; (4) efficiency; and (5) responsibility. I also believe that our disclosure requirements and guidance must evolve over time to reflect changes in markets and industry while being true to these principles, which in well-designed rules can be mutually reinforcing.

Turning to human capital, I believe that the strength of our economy and many of our public companies is due, in significant and increasing part, to human capital, and for some of those companies human capital is a mission-critical asset. Disclosure should focus on the material information that a reasonable investor needs to make informed investment and voting decisions; yet, applying this and the other principles I mentioned to human capital in the way businesses assess and disclose, and investors evaluate, for example, revenue or costs of goods sold, is not a simple task. That said, the historical approach of disclosing only the costs of compensation and benefits often is not enough to fully understand the value and impact of human capital on the performance and future prospects of an organization.

With that as context, my view is that to move our framework forward we should not attempt to impose rigid standards or metrics for human capital on all public companies. Rather, I think investors would be better served by understanding the lens through which each company looks at its human capital. In this regard, I ask: what questions do boards ask their management teams about human capital and what questions do investors—those who are making investment decisions—ask about human capital? For example, how do investors use human capital information to make relative capital allocations among similar organizations? Armed with general and sector-specific answers to these questions, we can better craft rules and guidance. I have read the draft recommendation prepared by the subcommittee and believe your views have significantly developed. Thank you for considering my prior comments.

Investment Research and Potential Regulatory Implications

Earlier this year, significant new rules relating to research (MiFID II) became effective in the European Union (EU), which changed how asset managers are permitted to pay for research in the EU. We have heard from a number of market participants regarding how these rules pose challenges for US firms and, in particular, raise questions concerning market practice and compliance among broker-dealers and asset managers in the US. In 2017, Commission staff issued temporary no-action assurances to broker-dealers that receive certain payments under MiFID II, in order to permit US firms to comply with MiFID II's unbundling requirements without triggering registration under the Investment Advisers Act.

It is our understanding that some market solutions have developed that may make extending the no-action relief unnecessary. For example, some asset managers have addressed the MiFID II unbundling requirement by absorbing the cost of research themselves and having their funds pay their brokers for trade execution services only. Other asset managers have created Research Payment Accounts to budget and track research costs at the fund level, permitting the funds to continue to pay for research through soft dollars and reconciling those payments to ensure compliance with MiFID II.

In addition to the regulatory compliance issues, as I mentioned during the December 13, 2018 meeting, I am concerned that the broad availability of research may be reduced as a result of MiFID II. I am particularly interested in hearing from this group regarding how MiFID II has changed the dynamics of the provision of research. For example, has MiFID II reduced the supply of research overall and/or the availability of research from a variety of broker-dealers, including smaller and specialized firms? Has MiFID II reduced the quality of research overall, or in particular sectors or for particular size issuers? More particularly, are advisers encountering challenges in obtaining the coverage and quality in research that they need to support their advisory services?

Our staff remains actively engaged with market participants on this issue and we continue to invite you to submit comments.[1] For those interested in this topic and the specific types of information we are looking for from market participants, I encourage you to review the speech that Dalia Blass, the Director of our Division of Investment Management, recently gave addressing this topic.[2]

[1] See SEC Staff Encourages Continued Engagement on Impact of MiFID II Research Provisions (Dec. 21, 2018), available at https://www.sec.gov/news/press-release/2018-301.
[2] Dalia Blass, Keynote Address: ICI Mutual Funds and Investment Management Conference (March 18, 2019) available at https://www.sec.gov/news/speech/speech-blass-031819.