SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks

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Thank you Jason [Healey] for that kind introduction.[1]
For many, December is a time to reflect on the past year and to look forward to what the New Year may bring. I believe organizations also should mark milestones, take stock of what has been done and what needs to be done, and adjust course accordingly.

My colleagues at the Commission and I go through this exercise relatively frequently, including to fulfill statutory reporting requirements—yes, like the public companies we regulate, we too have disclosure obligations.

In the past few months, we published a new, four year strategic plan and our annual report for fiscal year 2018.[2] We also participate in the annual report process for the Financial Stability Board and the Financial Stability Oversight Council.[3] In addition, our divisions and offices undertake similar reviews and, in some cases—notably, the Division of Enforcement and the Office of Compliance Inspections and Examinations—publish an annual report and exam priorities, respectively.[4]
Today, I would like to go through this exercise with respect to our rulemaking efforts. I will review our progress on the agenda for 2018, then discuss the agenda for 2019, and close with observations on certain of the key risks that we are monitoring—namely, Brexit, the LIBOR transition and cybersecurity risks.

Approach to the 2018 Regulatory Agenda and Review of Our Progress

We are required to publish a regulatory agenda on a semi-annual basis pursuant to the Regulatory Flexibility Act.[5] One year ago, I spoke about my perspective on this process, including the observation that the near-term portion of our "Reg Flex" agenda—in essence, the rulemaking expected to be completed in the coming year—had become too aspirational.[6] For example, 32 rules were listed as to-be-adopted in 2016, but less than 30 percent of the listed rules were adopted in that year. I believe this aspirational approach was driven in large part by the more than 80 rulemakings and the more than 30 reports and studies that the Dodd-Frank Act required the SEC to complete.[7] I thank my predecessors for tackling the lion's share of those.[8]
Recognizing the opportunity to recalibrate, the 2018 Reg Flex agenda was more focused than in the past—a change made to increase transparency and accountability, as well as to provide greater clarity to our dedicated staff.[9] The agenda embodied a collective effort, benefiting from the input of my fellow Commissioners, our division and office heads and many members of our staff on key questions, including: (1) what initiatives the agency could reasonably expect to complete over the next 12 months and (2) of those initiatives, which ones would have the most positive

impact on our Main Street investors. This exercise produced a tailored yet ambitious 2018 agenda, encompassing 26 different initiatives covering a broad array of topics.

During the last year, the Commission advanced 23 of the 26 rules in the near-term agenda, a good result on both a percentage basis (88percent) and an absolute basis.[10]

In addition, the Commission responded to major events and changes in the broader regulatory landscape by advancing several other initiatives not in the original agenda. For example, we issued guidance to public companies about disclosures of cybersecurity risks and incidents.[11] During the 2018 fiscal year, we also responded to a new congressional mandate by expanding a key registration exemption used by non-reporting companies to issue securities pursuant to compensatory arrangements,[12] and we provided relief for those affected by Hurricane Florence.[13]

To be sure, statistics often fail to tell more than a narrow story. Main Street investors—the market participants we have at the front of our minds—will not assess our work by the number or percentage of rules and initiatives we complete, but rather will be looking at what our efforts substantively do for them. With this metric—the interests of our long-term Main Street investors—in mind, I will discuss a few examples of our work in 2018.

Improving Our Approach to the Regulation of Investment Professionals

In April, the Commission proposed for public comment a collection of rules and interpretations applicable to investment professionals—both broker-dealers and investment advisers.[14] These proposals, individually and collectively, are designed to enhance retail investor protection and decision making by elevating the broker-dealer standard of conduct and reaffirming—and in some cases clarifying—the fiduciary standard for investment advisers, as well as requiring more candid and plain language disclosures. Using plain language, we are bringing the regulation of conduct and communications in line with the reasonable expectations of our Main Street investors. More specifically, the proposed rules seek to accomplish three things:

1. require broker-dealers to act in the best interest of their retail customers, by expressly requiring that the investment professional not place her or his interests ahead of the interests of the client;
2. reaffirm, and in some cases clarify, the fiduciary duty owed by investment advisers to their clients; and
3. require both broker-dealers and investment advisers to state clearly key facts about their relationship, including their financial incentives.

Importantly, the proposed rules are designed to preserve retail investor access—in terms of choice and cost—to a variety of types of investment services and investment products, while giving investors the tools to select the type of relationship that is appropriate for their needs and in line with their expectations.

This is a very important and long overdue initiative.

Broker-dealers and investment advisers both provide investment advice to their customers, but have different relationships and are subject to various different regulatory regimes. However, many retail investors do not have a firm grasp of the important differences between broker-dealers and investment advisers—(1) differences in the variety of services that they offer; (2) how investors pay for those services; and (3) the regulatory frameworks that govern their relationship. This is a complex set of issues, no doubt, but we must also recognize that access to investment advice is increasingly important to our society. And we must recognize that while the current framework needs improvement, it is extensive and in many areas functions well for our Main Street investors, particularly as compared to other jurisdictions.

Facilitating Capital Formation

Second, with respect to capital formation, the Commission took several meaningful steps throughout 2018 to help companies—including small companies—participate in our capital markets, while maintaining or improving important investor protections. For example, the Commission expanded the definition of "smaller reporting company."[15] The amended definition will allow nearly 1,000 additional companies to take advantage of scaled disclosure requirements, reflecting the principle that a one-size regulatory structure does not fit all public companies. The Commission also adopted final rules that eliminate requirements that are outdated, overlapping, or duplicative of other Commission rules or U.S. GAAP. These amendments will reduce costs for companies. Importantly, they will not adversely affect the availability of material information and, in many cases, they will enhance the quality of information available to investors. Combined, our capital formation initiatives make the option for issuers to join our public markets more attractive, ultimately to the benefit of Main Street investors, many of whom are searching for additional investment options.

Monitoring and Reacting to Our Evolving Securities Markets

We also have been monitoring our markets and market structure to evaluate whether they are meeting the needs of our Main Street investors.

For example, I have long believed that there should be greater regulatory focus on our fixed income markets, particularly the corporate and municipal bond markets.[16] These markets are particularly significant to retail investors, as well as American companies and our national infrastructure. To facilitate that effort, we stood up the Commission's Fixed Income Market Structure Advisory Committee—or "FIMSAC" as many people call it.[17] FIMSAC—which is made up of a diverse group of experts from across the country—had a highly productive first year. The Committee held four insightful public meetings and has provided the Commission with five thoughtful recommendations on ways to improve our fixed income markets.[18] I look forward to an equally successful second year for the FIMSAC.

We are also focusing on other aspects of our securities markets. Our Division of Trading and Markets held three roundtables this year to explore key markets issues, particularly: (1) the market structure for the securities of smaller, more-thinly traded companies; (2) regulatory approaches to combating retail fraud; and (3) access to markets and market data. The roundtables were candid and constructive, and staff in our Division of Trading and Markets is busy analyzing issues raised at the roundtables.

Speaking of our markets, we know that transparency is a bedrock of healthy and vibrant markets. I am pleased to report that we have also taken significant steps to make our markets more transparent. For example, in July, we adopted amendments that enhance the transparency requirements governing alternative trading systems, commonly known as "ATSs."[19] These amendments provide investors, brokers and other market participants—and the Commission—with increased visibility into the operations of these important marketplaces for equity trading.[20] These amendments are a credit to our staff's careful attention to market developments and needs and reflect my view that, since markets are constantly changing, we must regularly and critically evaluate our approach to regulation.[21]

Significant Initiatives for 2019

Whatever our accomplishments in the past year, our work is far, far from complete. That reality comes with the territory of ever changing capital markets. The near-term agenda for completion in 2019 is now publicly available.[22] Continuing with the themes of transparency, accountability and clarity of mission, the "Reg Flex" agenda for 2019 focuses on the initiatives we reasonably expect to complete.[23] I hope to have a blackline similar to the 2018 agenda—with 80 percent or more strikethroughs—a year from now. I will now discuss a few priority items for 2019.

Completing our Work on Rules Relating to the Standards of Conduct for Financial Professionals

Completing our rules relating to the standards of conduct for financial professionals is a key priority.

Since the April 2018 proposal, we have engaged with Main Street investors across the United States to discuss their experiences. SEC staff organized a series of seven roundtables around the country, providing Main Street investors an opportunity to speak directly with me, my fellow Commissioners and senior SEC staff—all in an effort to improve the proposed rules.[24] It is clear, based on these discussions, that we have the right perspective, namely, that the core obligations of investment professionals—and mandatory plain language disclosures—should match reasonable investor expectations.

The efforts of the SEC staff to deliver for Main Street investors in this important area have been exemplary. In addition to the investor roundtables, we launched a new webpage where investors can view samples of the proposed disclosure form and submit feedback.[25] The SEC's Office of the Investor Advocate engaged the RAND Corporation to conduct investor testing of the proposed disclosure form and has made the report available for review and public comment.[26] Our staff has been carefully reviewing all of this information, and the more than 6,000 comment letters,[27] as they work diligently to develop final recommendations.

Proxy Process

Another significant initiative for 2019 is improving the proxy process. Last month, the SEC staff held a proxy roundtable to discuss: (1) the proxy solicitation and voting process; (2) shareholder engagement through the shareholder proposal process; and (3) the role of proxy advisory firms.[28]I was pleased with this solutions-oriented event, which included a diverse group of panelists representing the views of investors, companies and other market participants. While we heard a wide range of views, we saw more agreement than disagreement, and I believe that we should act to improve each of these areas.

There was consensus among the panelists that the proxy "plumbing" needs a major overhaul. I encourage market participants to explore what such an overhaul would entail and to consider how technology, including distributed ledger technology, could improve the proxy plumbing. I realize a major overhaul could take time. So, I believe we should focus on what the Commission can do in the interim to improve the current system. The comment box for the roundtable remains open, and I encourage all those interested in improving the proxy plumbing to share their thoughts, particularly regarding actionable, interim improvements.

I also believe it is clear that we should consider reviewing the ownership and resubmission thresholds for shareholder proposals. The current $2,000 ownership threshold was adopted 20 years ago, and the resubmission thresholds have been in place since 1954. A lot has changed since then. We need to be mindful of these changes, and make sure our approach to the very important issue of shareholder engagement reflects the realities of today's markets and today's investors. As I have said before, when looking at the ownership and resubmission thresholds, we need to consider the interests of the long-term retail investors who invest directly in public companies and indirectly through mutual funds, ETFs and other products. With these long-term, retail investors in mind, we also should consider whether there are factors, in addition to the amount invested and the length of time shares are held, that reasonably demonstrate that the proposing shareholder's interests are aligned with those of a company's long-term investors.

For proxy advisory firms, I believe there is growing agreement that some changes are warranted. For example, there should be greater clarity regarding the division of labor, responsibility and authority between proxy advisors and the investment advisers they serve. We also need clarity regarding the analytical and decision-making processes advisers employ, including the extent to which those analytics are company- or industry-specific. On this last point, it is clear to me that some matters put to a shareholder vote can only be analyzed effectively on a company-specific basis, as opposed to applying a more general market or industry-wide policy.

Finally, there were other issues raised at the roundtable that we should consider, including: (1) the framework for addressing conflicts of interests at proxy advisory firms and (2) ensuring that investors have effective access to issuer responses to information in certain reports from proxy advisory firms.

The staff is looking at these and other issues, and I have asked them to formulate recommendations for the Commission's consideration. On timing, it is clear to me that the these issues will not improve on their own with time, and I intend to move forward with the staff recommendations, prioritizing those initiatives that are most likely to improve our markets for our long-term Main Street investors.

Capital Formation and Access to Investment Opportunities

Main Street investors, now more than ever before, are responsible for saving for retirement. Earlier this year, staff in our Office of Investor Education and Advocacy issued a bulletin to warn investors of risks associated with self-directed Individual Retirement Accounts, or IRAs.[29] With the shift away from traditional defined benefit pension plans, American workers are increasingly relying primarily on defined contribution plans, such as 401(k) plans and IRAs, to save for retirement.[30]We owe it to these investors to make sure they have access to a broad mix of investment opportunities to save for retirement and to achieve other financial goals. Accordingly, we are looking at initiatives to facilitate access to capital for issuers and to make sure Main Street investors have the best possible mix of investment opportunities.

Several of these initiatives parallel congressional legislation that received substantial bipartisan support. For example, the so-called JOBS Act 3.0 includes provisions to expand testing-the-waters and study our quarterly reporting regime.[31] Both of these initiatives are included on the agenda for 2019 rulemaking—in addition to other Congressionally-directed rulemakings relating to expanding Regulation A for public reporting companies.

To explore further whether we can improve the mix of investment opportunities for Main Street investors, the Division of Corporation Finance is looking at the private offering framework. Our "patchwork" private offering system is complex and it is time to take a critical look to see how it can be improved, harmonized and streamlined. The staff is working on a concept release to solicit input about key topics, including whether our accredited investor definition—a principal regulatory threshold for participation in private offerings—is appropriately tailored to address both investment opportunity and investor protection concerns.

Encouraging Long-Term Investment

I also believe it is important to consider ways to encourage long-term investment in our country. There is an ongoing debate regarding the adequacy and appropriateness of mandated quarterly reporting and the prevalence of optional quarterly guidance, and whether our reporting system more generally drives an overly short-term focus. I encourage

all market participants to share their views to let us know if there are other aspects of our regulations that drive short-termism.

Distributed Ledger Technology, Digital Assets and Initial Coin Offerings

Another area where the Commission and staff have spent a significant amount of time relates to distributed ledger technology, digital assets and initial coin offerings (ICOs).[32] I expect that trend will continue in 2019. A number of concerns have been raised regarding the digital assets and ICO markets, including that, as they are currently operating, there is substantially less investor protection than in the traditional equities and fixed income markets, with correspondingly greater opportunities for fraud and manipulation.
I believe that ICOs can be effective ways for entrepreneurs and others to raise capital. However, the novel technological nature of an ICO does not change the fundamental point that, when a security is being offered, our securities laws must be followed.

In an effort to centralize and better coordinate the staff's work on these important issues, the SEC recently announced the formation of a new Strategic Hub for Innovation and Financial Technology ("FinHub") within the agency. Staffed by representatives from across the Commission, the FinHub serves as a public resource for fintech-related issues at the SEC.[33] As the FinHub and our other activities demonstrate, our door remains open to those who seek to innovate and raise capital in accordance with the law.

Market Risks

Before closing, I want to briefly discuss three of the risks we are monitoring: (1) the impact to reporting companies of the United Kingdom's exit from the European Union, or "Brexit"; (2) the transition away from LIBOR as a reference rate for financial contracts; and (3) the principal topic of the following panel, cybersecurity.

Brexit

First, the potential effects of Brexit on U.S. investors and securities markets, and on global financial markets more broadly, is a matter of increased focus for me and many of my colleagues at the SEC. To be direct, I am concerned that:

1. The potential adverse effects of Brexit are not well understood and, in the areas where they are understood, are underestimated.[34]
2. The actual effects of Brexit will depend on many factors, some of which may prove to be beyond the control of the U.K. and E.U. authorities.
3. Our markets, at many levels—from multinational companies, to market infrastructure, to investment products and services—are international, and the effects of Brexit will be international, including on U.S. markets and our Main Street investors.
4. The actual effects of Brexit are likely to manifest themselves in advance of implementation dates and, based on corporate disclosures, some of those effects are upon us.
5. The actual effects of Brexit will depend in large part on the ability of U.K., E.U. and E.U. member state officials to provide a path forward that allows for adjustment without undue uncertainty, disruption or cost. That is a tall order that I believe requires: (a) a broad understanding of market interdependencies—knowledge that goes well beyond the labor and financial markets; (b) foresight—people and firms will act in their own interests and the interests of their shareholders; and (c) flexibility—miscalculations are inevitable and will need to be addressed promptly. More generally, limiting the adverse effects of Brexit requires a willingness of governmental authorities to look beyond potential immediate, local economic and other opportunities provided by a blunt transition and pursue a course that focuses on broad, long-term economic performance and stability. While many involved in the Brexit process agree with this perspective, and some important steps have been taken,[35] I do not yet see wide acceptance of this principle.

To be clear, these are my personal views, but it is appropriate to share them as they are reflective of the SEC's approach to Brexit. The SEC's responsibility is primarily related to the effects of Brexit on our capital markets. For example, I have directed the staff to focus on the disclosures companies make about Brexit and the functioning of our market utilities and other infrastructure.

We have seen a wide range of disclosures, even within the same industry. Some companies have fairly detailed disclosures about how Brexit may impact them, while others simply state that Brexit presents a risk. I would like to

see companies providing more robust disclosure about how management is considering Brexit and the impact it may have on the company and its operations.

With regard to market utilities and infrastructure, following the 2016 Brexit vote, SEC staff commenced discussions with other U.S. financial authorities, with our U.K. and E.U. counterparts, and with market participants, all with an eye toward identifying and planning for potential Brexit-related impacts on U.S. investors and markets. These discussions are ongoing, and I expect their pace to increase.

Transition Away from LIBOR

The second risk that I want to highlight relates to the transition away from LIBOR as a benchmark reference for short-term interest rates. LIBOR is used extensively in the U.S. and globally as a benchmark for various commercial and financial contracts, including interest rate swaps and other derivatives, as well as floating rate mortgages and corporate debt. It is likely, though, that the banks currently reporting information used to set LIBOR will stop doing so after 2021, when their commitment to reporting information ends. The Federal Reserve estimates that in the cash and derivatives markets, there are approximately $200 trillion in notional transactions referencing U.S Dollar LIBOR and that more than $35 trillion will not mature by the end of 2021.[36]

The Alternative Reference Rate Committee (or "Committee")—a committee convened by the Federal Reserve that includes major market participants, and on which the SEC staff and other regulators participate—has proposed an alternative rate to replace U.S. Dollar LIBOR—the Secured Overnight Financing Rate, or "SOFR." The Committee has identified benefits to using SOFR as an alternative to LIBOR. For example, SOFR is based on direct observable transactions. SOFR is based on a market with very deep liquidity, reflecting overnight Treasury repurchase agreement transactions with daily volumes regularly in excess of $700 billion.

A significant risk for many market participants—whether public companies who have floating rate obligations tied to LIBOR, or broker-dealers, investment companies or investment advisers that have exposure to LIBOR—is how to manage the transition from LIBOR to a new rate such as SOFR, particularly with respect to those existing contracts that will still be outstanding at the end of 2021. Accordingly, although this is a risk that we are monitoring with our colleagues at the Federal Reserve, Treasury Department and other financial regulators, it is important that market participants plan and act appropriately.

For example, if a market participant manages a portfolio of floating rate notes based on LIBOR, what happens to the interest rates of these instruments if LIBOR stops being published? What does the documentation provide; does fallback language exist and, if it exists, does it work correctly in such a situation? If not, will consents be needed to amend the documentation? Consents can be difficult and costly to obtain, with cost and difficulty generally correlated with uncertainty.

In the area of uncertainties, we continue to monitor risks related to the differences in the structure of SOFR and LIBOR. SOFR is an overnight rate, and more work needs to be done to develop a SOFR term structure that will facilitate the transition from term-based LIBOR rates.[37]

To be clear, a lot of progress has been made to facilitate the transition from LIBOR to SOFR. We have started to see more SOFR-based debt issuances, and we have seen promising developments in the SOFR swaps and futures markets.[38] But I want to make sure that market participants are aware of the need to plan for this important transition, as a lot of the work will fall on them.

Cybersecurity

The third risk I want to touch on is cybersecurity. Cybersecurity is something that we at the agency look at from a number of perspectives.

From an issuer disclosure perspective, it is important that investors are sufficiently informed about the material cybersecurity risks and incidents affecting the companies in which they invest. Earlier this year, the Commission issued interpretive guidance to assist public companies in preparing these types of disclosures.[39] The guidance also emphasized the importance of disclosure controls and procedures that enable public companies to make accurate and timely disclosures about material cybersecurity events, as well as policies that protect against corporate insiders trading in advance of company disclosures of material cyber incidents.

From a market oversight perspective, we continue to prioritize cybersecurity in our examinations of market participants, including broker-dealers, investment advisers and critical market infrastructure utilities. In assessing how firms prepare for a cybersecurity threat, safeguard customer information, and detect red flags for potential identity theft, for example, we have focused on areas including risk governance, access controls, data loss prevention, vendor management and training, among others. And given the interconnectedness of our markets, we

will continue to work closely with our counterparts at other federal financial regulatory agencies and the international community.

We also are focused on assessing and improving our own cybersecurity risk profile. We now have a Chief Risk Officer to help coordinate our risk management efforts across the agency. We have worked to promote a culture that emphasizes the importance of data security throughout our divisions and offices. The staff has also been engaging with outside experts to assess and improve our security controls. We recognize, however, that no system can be entirely safe from a cyber intrusion, and that there is a lot of work that remains to be done.

From an enforcement perspective, our Cyber Unit is dedicated to targeting cyber-related misconduct in our markets. Among other things—in addition to looking at potential violations in some of the areas I have just described—the Cyber Unit has focused on alleged misconduct involving intrusions into retail brokerage accounts, the submission of false regulatory filings and hacking to obtain material non-public information.

And finally, from an investor education perspective, our Office of Investor Education and Advocacy has worked hard to inform investors about cybersecurity hygiene and red flags of cyber fraud, in order to prevent investors from becoming victims in the first place. Those are just some of the areas we are looking at, and I look forward to discussing them further with today's distinguished panel members.

Conclusion

I am very pleased with our accomplishments in 2018, but much remains to be done and we are facing new challenges—some known and some that we will come to know. That is why the agenda for 2019 is ambitious. Yet it is pragmatic in the number of items, only a handful of which I was able to cover today.

Thank you for the invitation to speak to you.