Public Statement

Taking Significant Steps to Modernize Our Regulatory Framework

Chairman Jay Clayton

Sept. 26, 2019

Today, the Commission announced three important rulemakings.

- ***Modernizing the Approval Framework for ETFs***. We adopted a new rule that (1) sets forth a clear and consistent framework that will allow exchange-traded funds ("ETFs") meeting certain standardized conditions to come to market without obtaining an individualized exemptive order, and (2) amends certain forms to enhance disclosures for investors.
- ***Expanding "Testing-the-Waters" Communications to All Issuers.*** We adopted a new rule that will extend to all issuers the flexibility provided by the JOBS Act to communicate with institutional investors about potential IPOs and other registered offerings to better gauge market interest.
- ***Enhancing Regulation in the OTC Markets.*** We proposed amendments to rules governing the publication of quotations for over-the-counter ("OTC") securities designed to better protect investors from fraud and manipulation, while at the same time facilitating more efficient OTC trading in certain well-capitalized issuers.

These rulemakings share common themes. They modernize decades-old regulations, taking account of our experience, advances in communications technology and changes in the operation of our markets. Importantly, these common sense actions better align our regulations with the preferences and investor protection interests of our long-term Main Street investors, while also facilitating capital formation. I thank my fellow Commissioners and our dedicated staff for the effort, expertise and insight they brought to these important rulemakings.

Modernizing the Approval Framework for ETFs

The Commission approved the first ETF in 1992. Since then, ETFs have become a popular investment vehicle, particularly for the many Main Street investors who buy and hold these products over the long term. ETFs registered with the Commission have grown to $3.32 trillion in total net assets and provide investors with a diverse set of investment options. However, in order to come to market, ETFs still rely on individualized exemptive orders permitting them to operate under the Investment Company Act. We have granted over 300 of these individualized orders over the last quarter century. This individualized approach has generated differences in exemptive order representations and conditions, in turn, that have led to variations in the regulatory structure for existing ETFs.

As the ETF industry continues to grow in size and importance, particularly to Main Street investors, it is important to have a consistent, transparent and efficient regulatory framework for ETFs that eliminates unnecessary regulatory hurdles and asymmetries while maintaining appropriate investor protections. The new Rule 6c-11

modernizes this process by permitting certain ETFs to operate without the expense and delay of obtaining an individualized exemptive order from the Commission under the Act, but only if they satisfy conditions designed to promote investor protection and ensure that the exemption afforded these ETFs is in the public interest. In addition, we are updating certain ETF requirements to eliminate unnecessary disclosures while also requiring the publication or disclosure of information that will allow investors who purchase ETF shares in secondary market transactions to better understand the total costs of investing in an ETF.[1] In short, this rule provides a regulatory framework for ETFs that embodies our mission and reflects our more than two decades of experience with these investment products.

Importantly, however, while the rule would cover the vast majority of ETFs operating today, it would not cover certain types of ETFs, such as leveraged and inverse ETFs and non-transparent ETFs. I believe it would be premature to include leveraged and inverse ETFs within the scope of the rule before the Commission has addressed the investor protection concerns that have been raised regarding these products. Sponsors of leveraged and inverse ETFs (products which raise heightened investor protection concerns), as well as sponsors of non-transparent ETFs (a new type of actively managed ETF not subject to daily portfolio transparency), should continue to work with staff to seek the required exemptive relief.

Expanding "Testing-the-Waters" Communications to All Issuers

In 2012, the Jumpstart Our Business Act (the "JOBS Act") permitted a category of companies—emerging growth companies—to engage in oral or written communications with certain institutional investors to gauge interest in a contemplated initial public offering. These "testing-the-waters" communications have proven to be a popular and cost-effective means for evaluating market interest before incurring the costs associated with an initial public offering, and importantly, have provided benefits to both issuers and investors.

The Commission's new rule expands "testing-the-waters" to all issuers, and will encourage more issuers to consider entering our public equity markets. Issuers will be able to determine, either prior to or following the filing of a registration statement, whether potential institutional investors might have an interest in a contemplated registered offering. This benefits all investors—as a result of these communications, issuers can better identify information that is important to investors and enhance the ability to conduct a successful registered offering, ultimately providing both Main Street and institutional investors with more opportunities to invest in public companies that, in turn, provide ongoing disclosures to their investors.

Enhancing Regulation in the OTC Markets

Rule 15c2-11 generally requires broker-dealers to obtain and review certain basic information about an issuer before publishing quotations in the issuer's security in the OTC market. This is an important investor protection requirement—there is often less information available about companies traded in the OTC market as opposed to those on national securities exchanges. Notably, the current rule includes a so-called "piggyback exception" that essentially permits broker-dealers to continue to rely on the initial broker-dealer's information review perpetually. The result, unfortunately, is that broker-dealers can continue to quote the securities of companies that, in some cases, have not provided updated information in years or may no longer exist. These "dark" and defunct companies can be, and have been, used for fraudulent schemes.

The Commission's proposal seeks to update the rule and its exceptions, particularly the piggyback exception, to take account of our experience in this market, including our enforcement experience, and embrace the significant information technology advances that have been made since the "piggyback" exemption was adopted. The proposal is intended to bring greater consistency to (and otherwise enhance) the information available to investors and broker-dealers about OTC issuers.

Under the proposed amendments, among other things, the documents and information reviewed by broker-dealers must be both current and publicly available; broker-dealers would not be able to continue quoting a security under the piggyback exception if information about the issuer is not current and publicly available; broker-dealers would not be permitted to continuously quote the securities of shell companies; and certain burdens on broker-dealers

would be reduced for securities where information is more readily available and there is less concern about fraud and manipulation (for example, actively traded securities of well-capitalized issuers).

The proposal is a direct result of cooperative, cross-divisional efforts between our enforcement and rulemaking teams, and is a prime example of using what we have seen in the marketplace—including as a result of our market monitoring and enforcement efforts—to inform our policymaking. The Commission's Divisions of Enforcement and Trading and Markets have long been focused on, and expend enormous resources addressing, fraud in certain segments of the OTC market. For example:

- In 2017 and 2018, the Commission brought de-registration proceedings against hundreds of delinquent reporting OTC issuers.
- In 2017 and 2018, the SEC suspended trading in hundreds of OTC issuers, the vast majority of which involved securities that were piggyback-eligible and lacking current public information.
- Over the past several years, the Division of Enforcement has expended significant resources investigating numerous fraudulent schemes, particularly arising from shell companies and under the piggyback exception.

The majority of enforcement cases involving OTC securities have involved delinquent filings, which result in a lack of current, accurate or adequate information about an issuer. In addition, dormant shell companies can be misused as vehicles for fraud. Under the proposed amendments, thousands of OTC issuers that have gone "dark" would be required to provide additional material information to the market or lose their piggyback eligibility and hundreds of shell companies would no longer be piggyback eligible. As a result, these types of OTC issuers would become far less viable as vehicles for fraudulent and manipulative schemes.

Put simply, these amendments to Rule 15c2-11, if adopted, should improve issuer disclosures and make it easier to detect, deter and prevent fraud in our OTC markets.

* * *

These rulemakings represent the Commission's continued focus on modernizing our rules. I again thank my fellow Commissioners for their support. I am also grateful for the work of our dedicated and hard-working staff on these significant initiatives that will benefit investors, issuers and other market participants.[2]

---

[1] The Commission is also issuing an exemptive order granting conditional relief to broker-dealers and other market participants from certain Exchange Act requirements when engaging in certain transactions involving ETFs relying on Rule 6c-11. This additional relief facilitates the ability of broker-dealers and other market participants to engage in these transactions, thereby permitting the ETF to operate as intended and further reducing regulatory complexity and administrative delay.

[2] In particular, I would like to thank Dalia Blass, Sarah ten Siethoff, Brian Johnson, Melissa Gainor, Daniele Marchesani, Jacob Krawitz, Joel Cavanaugh, J. Matthew DeLesDernier, John Foley, Kay-Mario Vobis, Sara Cortes, Harry Eisenstein, Trace Rakestraw, Brad Gude, Melissa Harke, Amanda Wagner and Angela Mokodean from the Division of Investment Management; Bill Hinman, Betsy Murphy, Jonathan Ingram, Jennifer Zepralka, Heather Maples, Carolyn Sherman, Timothy Henseler, Donna Levy, Michael Coco, Luna Bloom, Maryse Mills-Apenteng and Coy Garrison from the Division of Corporation Finance; Brett Redfearn, Lizzie Baird, Mark Wolfe, John Guidroz, Joan Collopy, Laura Gold, Theresa Hajost, Sam Litz, Elizabeth Sandoe, Josephine Tao, Emily Westerberg Russell, Joanne Rutkowski, Natasha Greiner, Brandon Hill, Shauna Sappington and Darren Viera from the Division of Trading and Markets; S.P. Kothari, Chyhe Becker, Narahari Phatak, Vladimir Ivanov, Olga Itenberg, Anzhela Knyazeva, Lauren Moore, Adam Large, Alexander Schiller, Andrew Glickman, Jeremy Ko, Wei Liu, Ilia Rainer, Daniel Bresler and Rooholah Hadadi from the Division of Economic and Risk Analysis; Stephanie Avakian, Steven Peiken, Charlotte Buford, Glenn Gentry, Kerry Knowles, Melissa Hodgman, Marc Berger, Michael Paley, Jason Berkowitz,

Sarah Concannon, Michael Brennan, Jessica Regan, Margaret Cain, Philip Koski, Keith Prive, Hane Lee Kim, Caitlyn Campbell and David Frye from the Division of Enforcement; Bob Stebbins, Meridith Mitchell, Lori Price, Bryant Morris, Marie-Louise Huth, Robert Teply, Robert Bagnall, Maureen Johansen, Mykaila DeLesDernier, Kerry Dingle, Connor Raso, William Miller, Janice Mitnick and Natalie Shioji from the Office of General Counsel; Peter Driscoll, Carrie O'Brien, Christine Sibille and Joseph Murphy from the Office of Compliance and Inspections; Giles Cohen, Duc Dang, Ryan Wolfe and Jonathan Wiggins from the Office of the Chief Accountant; Adam Moore from the Office of the Investor Advocate; and Martha Miller, Julie Davis and Jennifer Riegel from the Office of the Advocate for Small Business Capital Formation.

Related Materials

- ETF (Final Rule)
- Expanding "Testing-the-Waters" Communications (Final Rule)
- Enhancing Regulation in the OTC Markets (Proposed Rule)
- ETF (Exemptive Order)