Speech

At the SEC: Nothing but Crickets Remarks at SEC Speaks

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Let me start by reminding you that my views are my own as a Commissioner and not necessarily those of the Securities and Exchange Commission ("SEC") or my fellow Commissioners. It is good to be back at SEC Speaks and to know that the content shared here today is available for anyone who may wish to access it.

Last time I was here, I talked about the SEC's "secret garden"—the maze of staff guidance that serves to define practices across the securities industry in a way that may be inconsistent with a plain reading of the rulebook.[1] This guidance is not promulgated through notice-and-comment rulemaking, but appears in staff statements and speeches, phone calls, some types of no-action letters, and the like. Some of this guidance is found only in the high-priced whispers of a select few attorneys or auditors. Nobody can challenge these diktats because they are not final agency action, but compliance is mandatory for an entity wishing to avoid SEC delays, denials, and enforcement and examination scrutiny. So everybody silently complies.

Since I gave that speech, a particularly pernicious weed has sprung up in the secret garden: Staff Accounting Bulletin ("SAB") 121 and related guidance.[2] The Office of the Chief Accountant ("OCA") prepared the SAB without the input of the full Commission, but, as with other SABs, staff follows SAB 121 in administering the disclosure requirements of the federal securities laws.[3] SAB 121 directs public companies that safeguard crypto assets for clients to put a liability and corresponding asset on their balance sheet and adjust them as the value of the asset changes. The SAB was issued apparently without input from the public or banking regulators, who subsequently have expressed concerns.[4] The Government Accountability Office last October ruled that the Commission should have submitted SAB 121 to Congress under the Congressional Review Act because it was an "agency statement" "of future effect" that the Commission "designed to interpret and prescribe policy."[5] Despite the negative attention, OCA, through conversations after the SAB's issuance, has broadened its scope to cover all registered broker-dealers. To make matters worse, OCA issued—orally at a conference of accountants—a multi-pronged framework for applying SAB 121 to broker-dealers. The Commission has not published that framework or any subsequent staff efforts to clarify the framework's scope, but many auditors and broker-dealers are treating it as binding. It is driving broker-dealers to allocate significant capital to their crypto custody businesses or to avoid the business altogether. SAB 121 arguably does not protect investors. Its capital implications keep out of the business many banks and broker-dealers that have long years of custody experience.[6] Moreover, as a consequence of being on the balance sheet, if the custodian fails, these assets could be treated as if they belong to the failed entity, not the customers of that entity.[7]

Rules of such broad effect should be set by the full Commission, not by staff answering only to the Chairman. In a Reorganization Plan 10 world,[8] ensuring that policy decisions are not delegated to the staff can be particularly tricky. Jack Katz, who served for two decades as Secretary of the SEC and is being honored tonight with the William O. Douglas award,[9] made this point in congressional testimony that recommended, among other things, greater involvement of the Commission in interpreting regulatory policy.[10] Katz contended that having the Commission "micromanage" or displace the staff in performing their "daily responsibilities" would be "a disastrous outcome," but "the Commission is the final authority on questions of regulatory policy, both in the interpretation of rules and in periodically overseeing and engaging in discussions of the priorities of each division."[11] The Commission appropriately relies on the staff to work through difficult technical questions about the application of the law to particular facts and circumstances, but should not leave to the staff decisions that broadly govern market practices.

Today, however, I want to focus on a different problem—the dwindling of genuine Commission and staff engagement with the public. The Commission—not the staff or market participants—is to blame. One manifestation is the way rules are made these days: very broad proposals, unreasonably short public comment periods, pared back final rules with substantial elements on which the public has not commented, and little SEC engagement in implementation discussions. The recent money-market fund rule is an example of this phenomenon. It went out with—among other provisions—an unworkable swing-pricing element and emerged with a mandatory liquidity fee.[12] Had the Commission sought robust comment on the fee before adopting it, we would have learned that it is unworkable for many funds. The Commission should think about each rule proposal as an opportunity to foster a public discussion with the goal of developing the best solution to a carefully identified problem, not as the opening bid in a hard-driving negotiating strategy designed to force a cowed public to accept a slightly less onerous—though perhaps still unworkable—final rule.

Rulemaking designed to engage the public takes time, something that is in short supply for an industry inundated with new rules and rule proposals from the SEC and other regulators. A recent conversation with small- and medium-sized advisers brought this point home. They told me that dealing with existing rules and implementing new ones precludes spending the time to read, let alone comment on, proposed rules. Further exacerbating the burden of commenting, rule proposals often fail clearly to identify a problem that needs solving, which makes offering alternative solutions difficult. The Commission, for example, has left commenters guessing about the problems motivating the safeguarding rule and the predictive data analytics rule.

The reduction in genuine engagement with the public is not limited to the rulemaking process. As I stated in the secret garden speech, much of the Commission's day-to-day work does not and need not proceed through notice-and-comment rulemaking. People routinely approach the staff with questions about how the law applies to their unique facts and circumstances. An important responsibility of many SEC staffers is to help the industry work through difficult regulatory issues, whether in the context of a new product filing, a broker-dealer application, a registration statement, an exemptive application, a request for no-action relief, or a query about the application of a rule to a unique set of facts and circumstances. Historically, the Commission staff has done this type of work through the Divisions' Offices of Chief Counsel and Chief Accountant, the Commission's Office of Chief Accountant, and other offices across the Commission. The staff made itself accessible, and the public had many productive opportunities to engage with the staff. Interactions with a regulator like the SEC were never stress-free, but the "Come in and talk to us" mantra was a genuine invitation to come in and grapple with difficult issues in a robust back-and-forth.

Productive interactions with the SEC are fewer and further between than they were in the past. When individuals and entities come to the SEC with their novel ideas, their feedback, their concerns, their objections, their questions about implementation of a new rule or application of an old one to new circumstances, too often now they are met with . . . well, crickets. Neither staff expertise nor issues ripe for analysis are lacking, so what has changed? In part, the staff, run ragged by a punishing rulewriting agenda, does not have the bandwidth to think about hard, novel legal questions. The remote work norm also may play a role as it reduces opportunities for spontaneous staff collaboration to work through tough questions. The root of the problem, though, is that the Commission discourages the staff from offering much more than silence, shrugs, sighs, and slow-walking. The culture at the top of the SEC has changed, which in turn has changed the way the agency interacts with the public.

Countless people have told me that they used to feel comfortable coming in and speaking with the Commission and its staff, but no more. When it comes to interpretive guidance, “the Commission is closed for business.” New product ideas? “Not now.” Approval to do things for which other firms already have approval? “That permission was very limited.” Feedback on how to a particular set of facts interacts with a new rule? “We cannot provide legal advice.”

Interactions that do occur often are an interminable round of unproductive monologues before an unresponsive audience. Even processes that historically have been straightforward, such as filing for new funds, have become complicated. The registration process too often involves unpredictable timelines, inconsistent comments, and an unprecedented lack of transparency. A fund sponsor might receive dozens of comments on a filing for a fund when the only distinction from an existing fund is the asset class in which it invests. Product ideas are abandoned before they are submitted to the Commission staff for consideration or after multi-year processes produce nothing but large legal bills and a loss of confidence in the Commission.

Some perceive meeting with the Commission is not only unproductive, but inadvisable. Sometimes people meet with me against the advice of counsel or only with counsel present. Other people have told me that they desperately want to have substantive discussions with the staff but worry that the inevitable result of such a meeting would be a call from enforcement, not a concerted effort to work through complex regulatory issues. The Commission’s announcement of a large ramp-up in its cyber- and crypto-enforcement unit, repeated assertions that the crypto industry is lawless, and treatment of cyber-incidents as fertile ground for enforcement actions add to these fears. These concerns are not limited to crypto and cyber. Other people have told me that they are less inclined now than in the past to keep us updated during times of market stress because they fear subsequent rulemaking premised on the fact that those conversations occurred. Think funds during the early days of COVID. We are scaring people off from coming in and having a conversation with us.

The stilted communication, half-hearted engagement, quick-draw of enforcement guns, and limited transparency that characterize the Commission’s current relationship with the industry we regulate should concern anyone who cares about this great institution and the amazing markets we regulate. The increasing chasm that has emerged between the regulator and the regulated undermines industry’s ability to serve investors and companies trying to raise capital. Given how regulated the securities markets are, developing new products or improving existing ones often requires conversations with, and sometimes regulatory action from, the SEC. By not engaging in nuanced analysis of legal questions, we create an environment in which overcompliance is the standard. Even if it does not technically make innovation impossible, smaller entities, which tend to be more innovative, cannot afford defensive overcompliance.

Dissuading people from coming in to speak with us also deprives us of valuable information that we need to regulate the markets. Routine and regular conversations with investors, regulated entities, issuers, legal practitioners, accountants, fund boards, compliance officers, academics, policy experts, and others help us to understand the financial markets we oversee. Information-gathering efforts by our examination and enforcement staff are no substitute.

All of us—the Commission, staff, and the public—have a role to play in reigniting productive conversations between the SEC and the public. The *Commission*, of course, must start the process and has the biggest role to play. As we often point out, tone from the top matters. Staff and market participants have little power to change a dynamic that the Commission has set in motion.

- First, we should pare back the rulemaking agenda so that we and the public can focus appropriate attention on each rule proposal.
- Second, we should use concept releases, public roundtables, and potentially consensus workshops to help us identify problems in need of solving and workable solutions.
- Third, we should propose realistic rules without clickbait provisions, which occupy commenters’ attention and invariably fall away at the adopting stage.
- Fourth, we should form an advisory committee made up of chief compliance officers, whose perspective I have found invaluable in understanding how rules actually operate.

- Fifth, we should consider providing greater insight into where a registration statement or an application by a potential registrant is in its review process.
- Sixth, we should direct staff to clearly articulate specific issues delaying Commission action and a plan for resolving them.
- Finally, we should encourage the staff to use its expertise to work through difficult regulatory issues, including the application of existing rules to new technologies. It should direct staff to consider not only how these technologies could harm investors, but how blocking them could harm investors. We should empower the staff to facilitate the entry of new products and providers into the market in a compliant, yet commercially viable way.

Once the Commission takes these steps, the hard-working, talented Commission *staff* also has a role to play in restoring a healthy relationship with the public:

- First, look for opportunities to apply your deep expertise to difficult legal, accounting, economic, and technical problems. The intellectual challenge of grappling with these complex questions is part of what drew many of you to join the SEC staff.
- Second, foster a culture of curiosity and collaboration by working with colleagues across the Commission on tackling the difficult questions.
- Third, in your interactions with the industry, be as precise as possible about the nature and magnitude of your concerns and as clear as possible about anticipated timing.
- Fourth, speak up when you have a concern or question. The Commission makes the policy decisions, but you inform those decisions. Flag unsound legal, economic, or accounting analysis, identify facts that need to be corrected, and raise procedural concerns. As with any collection of smart people, universal agreement is unlikely, but you may find others who share your concerns.
- Finally, cultivate mutual respect and frank communication with the public. When a rulemaking is completed, look for opportunities to discuss the rules at industry conferences and assist in smooth implementation. When a registrant or registered entity discovers a problem and brings it to your attention, work with the registrant to solve it in a way that benefits investors and the markets. Look for appropriate opportunities to get to know the person on the other end of the phone line.

Market participants can nudge the SEC in the right direction, although real progress depends on the Commission's willingness to engage. Forgive me if these steps seem laughably basic, but I underscore them because they can make a difference. This kind of interaction is not only acceptable, but welcome to a Commission that is committed to careful regulation. So although crickets are the current SEC's response to many inbound inquiries, when things change, the following may help facilitate discussion:

- First, optimize any meetings you have with the staff. Prepare an agenda that outlines what you hope to convey and identify what you are seeking from the meeting. If there are related materials that would help facilitate a productive meeting, email those well in advance.
- Second, if you want to present a novel idea, conduct a preliminary high level legal analysis before meeting with the staff. Although you may not want to invest significant time and resources in an idea that may not be viable, showing that you have done the basic due diligence is an important indication of your good faith and commitment to exploring the idea. This analysis can identify areas where legal clarity is needed. This exercise also will help you demonstrate if what you are doing merely iterates on something the Commission has already permitted, which may make it easier for the Commission to get comfortable with the idea.
- Third, if you want to do something that involves numerous complex legal questions, break down the components of your proposal and the related legal issues to determine the feasibility of an iterative approach toward your final goal. Iterative progress and small-scale experiments can be illuminating for both the Commission and the public.
- Fourth, if a broader group shares your novel legal questions, you may want to develop a consensus on the messages and questions you present to the Commission.

- Fifth, if the staff reacts negatively to your inquiry, try to identify their concerns and whether the staff sees a legal path for you to move forward. If you get a negative response, seek clarity on the legal basis of the staff's position. Ask for specific reasons. What questions and concerns need to be addressed? Are there particular regulatory obstacles?
- Sixth, document your interactions with the Commission. If you are two or three years into a process without progress, and you have regularly been reaching out and trying to respond to the staff's concerns, the documentation will prove invaluable.
- Seventh, do not be a stranger and do not give up. Carefully consider what the staff is saying. If you do not see a strong legal justification for stopping your idea, do not give up. Be realistic about the timeline, but, if you do not hear back from the Commission, keep following up. Innovation is not linear, and the path to launching an innovative idea will not always be straight. Try to see things from the SEC's vantage point and to learn from staff's concerns, but push back when those concerns are not legally grounded. Dealing with an agency that will not give you clear, legally sound answers is frustrating. Agencies, however, are not monoliths; even now, people within the agency may share your frustration and may be making arguments similar to your own in internal SEC conversations.

I welcome your input in refining my suggestions to restore trust and fluid communication between the public and the SEC.

In her book following her tenure as a commissioner, Roberta Karmel, whom we are now mourning, called for a "revitalize[d] securities regulation."[13] She understood that "regulation designed for the purpose of achieving greater social justice through increased prosperity must enthusiastically endorse private enterprise and administrative due process."[14] More than forty years later, that reminder that a deep respect for private enterprise and administrative due process makes us better at our job of regulating still resonates. Together—because the outcomes of our work are the result of the collective contributions of many—we can build a better SEC. This work requires the small efforts of many people inside and outside the agency.

The poet Mary Oliver, who, as I did, grew up outside Cleveland, Ohio, wrote beautifully about a cricket on a hillside. She observed its "great energy" and "humble effort" as it "mov[ed] the grains of the hillside."[15] I hope for an SEC that greets individuals and entities with crickets—but only the Mary Oliver kind: civil servants who "humbly" and with "great energy" labor, day in and day out, to make the SEC and the markets it regulates better by pushing one grain uphill at a time.

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[1] Hester Peirce, SECret Garden (Apr. 8, 2019), https://www.sec.gov/news/speech/peirce-secret-garden-sec-speaks-040819 ("[W]hen a patchwork of public and non-public guidance has become so comprehensive that market participants can say, only half-jokingly, that entire sections of our rulebook are irrelevant, similar questions about fairness and transparency arise: Are all similarly situated firms aware of the non-public guidance? Does the staff's guidance reflect a thorough consideration of the likely benefits and costs of that guidance? Does access to our markets depend on hiring counsel that has access to the non-public views of the staff? Will market participants change their behavior in ways that may not make sense under our rules as written to comply with the vast body of guidance, much of which may not be publicly available?") (footnote omitted).

[2] Staff Accounting Bulletin 121 (Mar. 31, 2022), https://www.sec.gov/oca/staff-accounting-bulletin-121 ("SAB 121").

[3] *Id.* ("The statements in staff accounting bulletins are not rules or interpretations of the Commission, nor are they published as bearing the Commission's official approval. They represent staff interpretations and practices followed by the staff in the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws.").

[4] *See, e.g.*, Travis Hill, Vice Chairman of the Federal Deposit Insurance Corporation, Remarks at the Mercatus Center on "Banking's Next Chapter? Remarks on Tokenization and Other Issues" (Mar. 11, 2024), https://www.fdic.gov/news/speeches/2024/spmar1124.html ("This treatment sharply departs from how custodians account for all other assets held in custody, which are generally held off-balance sheet and treated

as the property of the customer, not the custodian. On-balance sheet recognition triggers the full panoply of capital, liquidity, and other prudential requirements *only* for bank custodians, which makes it prohibitively challenging for banks to engage in this activity at any scale. It is worth asking whether it is in the public interest for one crypto exchange to provide custody services for most of the market in approved Bitcoin exchange-traded products, while highly regulated banks are effectively excluded from the market") (footnotes omitted). Further, Vice Chairman Hill contends that because SAB 121 applies to "crypto-assets," a broadly defined term, it may encompass other tokenized real-world assets. *Id*. ("[T]he SEC's definition of 'crypto-asset' is extremely broad and could be read to capture not just blockchain-native assets but also tokenized versions of real-world assets. I think this is a clear example of why it is generally constructive for agencies to seek public comment before publishing major policy issuances, and at a minimum believe it would be helpful to clarify that SAB 121 does not apply to the wider universe of tokenized assets beyond blockchain-native assets.") (footnote omitted).

[5] U.S. Government Accountability Office, Securities and Exchange Commission—Applicability of the Congressional Review Act to Staff Accounting Bulletin No. 121. 2023, File No. B-334540 (Oct. 31, 2023), at 5, 8 https://www.gao.gov/assets/870/862501.pdf. The Government Accountability Office did not opine on whether the Administrative Procedure Act legally mandated that the Commission subject SAB 121 to notice and comment. *See id.* at 7 ("Here, in regard to the Bulletin, we are not opining on whether the Bulletin is subject to APA's notice and comment provisions. Rather, we are opining on a different issue: whether the Bulletin is a rule under CRA. CRA does incorporate APA's definition of rule but does not incorporate APA's notice and comment provisions."). As subsequent valuable input from the public has made clear, the Commission would have benefited from notice-and-comment.

[6] SAB 121 does not directly set capital requirements, but affects the application of various capital regulations such that when the price of crypto assets rises, so too do custodians' capital requirements.

[7] *See, e.g.*, Letter from Conference of State Bank Supervisors to the House Financial Services Committee (Feb. 28, 2024), at 2, https://www.csbs.org/sites/default/files/2024-02/2024.02.28_240222%20SAB121-HJRES109%20Letter%20(FE).pdf ("[A]ssets held in custody for the benefit of customers are considered accounted for off-balance sheet – and thus protected in bankruptcy – because they remain the assets of the customer. Requiring custodied crypto-assets to be accounted for on-balance sheet risks losing the bankruptcy remote protections of custody services.").

[8] Reorganization Plan No. 10 of 1950, § 1, https://uscode.house.gov/view.xhtml?req=granuleid:USC-1999-title5a-node78-leaf108&num=0&edition=1999 (transferring "from the Securities and Exchange Commission . . . to the Chairman of the Commission . . . the executive and administrative functions of the Commission, including functions of the Commission with respect to (1) the appointment and supervision of personnel employed under the Commission, (2) the distribution of business among such personnel and among administrative units of the Commission, and (3) the use and expenditure of funds.").

[9] The Association of Securities and Exchange Commission Alumni, Inc. (ASECA) is presenting the award. *See* https://www.secalumni.org/jonathan-g--katz.

[10] Statement of Jonathan G. Katz Before the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, and The Subcommittee on Government Organization, Efficiency and Financial Management, United States House of Representatives. (Mar. 10, 2011), at 2, https://oversight.house.gov/wp-content/uploads/2012/01/J_Katz_Testimony_03-10-11_TARP_hearing.pdf ("The ability of the five-member Commission to interpret policy and oversee staff implementation of policy must also be strengthened.").

[11] *Id*. at 8.

[12] Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A (July 12, 2023), https://www.sec.gov/files/rules/final/2023/33-11211.pdf.

[13] Roberta S. Karmel, Regulation by Prosecution 339 (1982).

[14] *Id*.

[15] Mary Oliver, *Song of the Builders*, Why I Wake Early: New Poems, 60 (2005).