Securities Regulation Daily Wrap Up, TOP STORY—Gensler and Chopra field questions at dual confirmation hearing, (Mar. 2, 2021)

Securities Regulation Daily Wrap Up

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Gary Gensler and Rohit Chopra were asked repeatedly about their plans to push SEC and CFPB regulations beyond Congressional mandates.

The Senate Banking Committee heard testimony from Gary Gensler and Rohit Chopra and their qualifications to lead the SEC and the Consumer Financial Protection Bureau (CFPB), respectively. Although there were few surprises, both nominees were asked about their plans to expand their respective agencies' rules into new areas such as climate change disclosure at the SEC. The hearing lasted just over three hours, one of the longer hearings in recent memory, according to Senate Banking Committee Chair Sherrod Brown (D-Ohio).

Gensler and Chopra nominations. President Biden nominated former CFTC Chair Gary Gensler to lead the SEC. Gensler most recently had been leading the Biden transition's agency review team for banking and securities. As CFTC chair, Gensler was one of the first agency heads to begin implementation of the Dodd-Frank Act's derivatives reforms following the Great Recession. Gensler has recently been Professor of the Practice of Global Economics and Management at MIT Sloan School of Management, co-director of MIT's Fintech@CSAIL, and senior advisor to the MIT Media Lab Digital Currency Initiative. In the latter post, regarding digital currencies, Gensler has at times suggested virtual currencies such as Ripple may have been investment contracts and, thus, securities, but his background in the area also could suggest an opportunity for him as SEC chair to recalibrate existing SEC guidance on digital assets. In December 2020, the SEC brought a civil case against Ripple Labs, Inc. alleging that the company, its CEO, and its executive chairman conducted an unregistered offering of the virtual currency XRP.

There is precedent for selecting a former CFTC chair to also lead the SEC. Mary Schapiro, for example, led the CFTC before becoming the first person to have led both the CFTC and the SEC. However, unlike Schapiro, Gensler does not have prior experience as an SEC commissioner. Gensler has followed a path familiar to many high-ranking federal officials in recent administrations that leads from Goldman Sachs, to the Treasury Department, to becoming an agency head or other close presidential adviser. If confirmed, Gensler could be expected to take a somewhat more aggressive approach to regulating Wall Street than his immediate predecessor.

In prepared remarks, Gensler emphasized the benefits of stronger SEC enforcement. "In the decades since, we have seen that when the SEC does its job—when there are clear rules of the road and a cop on the beat to enforce them—our economy grows and our nation prospers," said Gensler. "But when we take our eyes off the ball—when we fail to root out wrongdoing, or to adapt to new technologies, or to really understand novel financial instruments things can go very wrong. And when that happens, people get hurt." With respect to financial technology, Gensler said: "I believe financial technology can be a powerful force for good—but only if we continue to harness the core values of the SEC in service of investors, issuers, and the public."

Both the North American Securities Administrators Association and the American Securities Association had expressed support for Gensler ahead of his confirmation hearing.

President Biden nominated Chopra to be Director of the CFPB. Previously, Chopra became a commissioner on the Federal Trade Commissioner in May 2018. Chopra also had helped to stand-up the CFPB following enactment of the Dodd-Frank Act and served as the CFPB's Assistant Director with an emphasis on student loans. Currently, the CFPB is led by Acting Director Dave Uejio, whom President Biden appointed to that role on January 20, 2021 after Trump Administration CFPB Director Kathleen Kraninger resigned.

In his prepared remarks, Chopra wrote of the potential crises ahead arising from the COVID-19 pandemic. Specifically, he suggested a coming wave of loan defaults and auto repossessions. He also flagged the long-running issues with consumer credit disclosures, the accuracy of credit reports, and stressed housing markets, especially those in communities of color.

"In the last economic crisis a decade ago, we saw how unlawful and avoidable foreclosures proved to be catastrophic in cities, small towns, and rural areas alike, contributing to deeper social divisions and inequities," said Chopra. "We once again face an important test to ensure that troubles in the housing market do not sabotage the recovery of our local economies."

Senators' prelude to more pointed questions followed familiar patterns. In his opening remarks, Brown cited a widening racial home ownership gap and suggested the Trump-era CFPB catered to the needs of big business. Brown also noted the SEC's need to address numerous issues like climate change, the recent market volatility, and the perils of markets without safeguards (he suggested the Texas electricity market's performance during recent winter storms as an example). Ranking Member Pat Toomey (R-Pa) voiced concerns about "burdensome" regulation by enforcement and the CFPB's unaccountability to Congress via the appropriations process. Toomey called Gensler knowledgeable but worried Gensler may lead the SEC to adopt a "liberal social agenda."

Maryland Senators Ben Cardin (D-Md) and Chris Van Hollen (D-Md) introduced Gensler as having "broad experience" and possessing "stellar qualifications and judgment," respectively. Senator Richard Blumenthal (D-Conn) introduced Chopra as someone who is sensitive to communities of color and whom consumers can be sure is in their corner and has their backs.

Brown led off the two rounds of questions by asking both Gensler and Chopra if they would commit to diverse hiring at their respective agencies. Gensler and Chopra both quickly answered in the affirmative. Thereafter, the questions turned to the subject matter of Gensler's and Chopra's respective agencies, should they be confirmed by the Senate.

Gensler queries. The first SEC-specific question for Gensler addressed the market volatility surrounding the trading of GameStop stock in late January 2021. In particular, Brown wanted to know about the influence of the gamification of stock trading. Gensler said such volatility is the product of both tensions between buyers and sellers but also a story of how technology is changing finance. For Gensler, the issues focus on best execution for investors and investor protections regarding behavioral prompts on trading platforms.

Toomey urged Gensler to consider the good government reforms he had outlined in a letter to SEC Acting Chair Allison Herren Lee. Gensler said the letter was helpful and that, if confirmed, he would work with Toomey and SEC staff on those senator's suggestions. Toomey then shifted the discussion directly into ESG issues. Toomey first cited a letter from GOP lawmakers urging the SEC to disapprove a Nasdaq rule change proposal that would require listed companies to meet Nasdaq diversity goals. Gensler said he would consider the GOP letter as one of the many comments submitted on the proposal if he is confirmed. Gensler added that diversity generally benefits decision making and that he is committed to diversity at the SEC. (Sen. Bob Menendez (D-NJ) and Rep. Gregory Meeks (D-NY) have re-introduced the Improving Corporate Governance Through Diversity Act (H.R. 1277; S. 374)).

Toomey then proposed a hypothetical in which he asked if it would be material to know about a company's spending on renewable forms of energy when that company spends little overall on electricity. The question was designed to elicit Gensler's views on the breadth of the materiality concept in federal securities law. Gensler agreed that materiality is key and that he would consider the economic aspects of materiality. Specifically, Gensler said materiality depends on the total mix of information such that a small item must be considered in context. Toomey continued the hypothetical, suggesting that the small nature of an expenditure would be per se nonmaterial. Gensler replied that recently many investors had, via proxy votes, made it clear that this kind of information is material.

Senator Cynthia Lummis (R-Wyo) also asked about the materiality of climate disclosures (Wyoming is a leading coal producing state). Gensler said such disclosures can be pro-issuer and pro-investor but that materiality is still the key. Gensler suggested that having clearer rules on climate disclosure could help issuers who are unsure of how to make these disclosures to provide the information investors have said they want.

Menendez said he plans to re-introduce the Shareholder Protection Act, which calls on companies to disclose their political spending, something the senator said deserves attention because of how many companies are apparently reconsidering such donations following the January 6, 2021 insurrection at the U.S. Capitol. Gensler said that disclosure is key, but without pre-judging a particular issue, disclosure would be grounded in materiality. Gensler did note that numerous recent shareholder proposals sought disclosure of corporate political donations. The SEC is currently barred under the latest omnibus appropriations legislation from using any funds to finalize political spending rules, but that policy rider could be removed beginning in the next fiscal year appropriations bill.

Senator Van Hollen also queried Gensler about ESG disclosures by asking if Gensler would keep an open mind about the evolution what a reasonable investor is in the context of disclosure. Gensler expanded upon his previous answers to other similar questions by stating that the investor community gets to decide if an item is material in the total mix of information. Gensler said the SEC could provide consistency and comparability to ESG matters.

With respect to digital assets, Sen. Mike Rounds (R-SD) asked what can be done about virtual currencies issuers going overseas. Gensler said the issue raises questions about investor protection, such as how to promote innovation while maintaining investor protections. Senator Bill Hagerty (R-Tenn) also inquired about digital assets. In reply, Gensler said it is important to remain technology-neutral as a regulator and hold true to the SEC’s mission. For Gensler, the key is determining whether a digital asset is a security or investment contract within the SEC’s purview, although it may be for Congress to determine who regulates non-securities digital assets.

Senator Lummis also commented in the context of digital assets that the SEC had become a "black hole for innovators." Gensler replied that markets change and evolve and the SEC can provide various types of guidance, including no-action letters. Gensler also reiterated that the security of private keys is critical in the digital asset space and that it is likewise critical to keep blockchain markets free of fraud and manipulation.

In reply to Sen. Thom Tillis (R-NC), Gensler explained how the SEC already has a transaction tax. Gensler said the SEC collects a "modest" transaction fee from issuers amounting to more than $1.8 billion. Gensler noted that U.S. markets had not experienced any negative effects from the SEC’s fee. The question had been aimed at the issue of a financial transaction tax, which has been the subject of legislation re-introduced in Congress.

Senator Elizabeth Warren (D-Mass) would ask about a range of topics in questioning Gensler. On climate change, Gensler said there was no reason for firms to hide climate risks. With respect to predatory private equity activities, Gensler said the Investment Advisers Act has at its heart disclosure requirements about fees and conflicts of interest. In the GameStop/Robinhood context, Gensler suggested that arbitration agreements may have a place, but that customers should have an avenue to address claims in courts. Warren’s question about Robinhood and GameStop had roots in an earlier question from Sen. Mark Warner (D-Va), in which Warner suggested that Robinhood’s business model treated customers and products rather than as customers.

Chopra questioning. Brown started the questioning of Chopra by asking about whether the CFPB could prevent another foreclosure crisis. Chopra replied that the Great Recession had devastated many communities, especially communities of color, but that regulators then had missed critical signs. In answer to a follow-up question from Brown, Chopra elaborated that unlawful and egregious practices should be stopped because that it the role of the CFPB. Chopra added that it is important to review how firms enter markets with an eye to tomorrow’s risks.

Toomey's questions to Chopra reiterated Toomey's concerns about the CFPB not being within the Congressional appropriations process. Toomey, citing an editorial by The Wall Street Journal editorial board, also suggested in his opening remarks that Chopra was hostile to some interests that are regulated by the CFPB. During questioning, Toomey asked Chopra about remarks Chopra had given in which Chopra said those who want the CFPB in the appropriations process are "shilling for predatory lenders." Chopra said he regretted making the statement but that his point was that regulators should stay clear of political influence.

Senator John Tester (D-Mont) inquired how Chopra would address regulations defining the term "qualified mortgage." Chopra said the CFPB would not dictate housing finance policy and that he would keep an open mind on the issue. Chopra added that a balance needs to be struck between consumer protection and access, but that no one would want to go back to the era of liar loans before the Great Recession.

Still on the issue of housing, Warren asked about the impending housing cliff. Chopra replied that he would work with other regulators and use all tools in the toolbox. Chopra said the goal is to keep people in their homes and especially not to force people out of their homes during quarantine for the pandemic.

Both of Georgia's new Democratic senators queried Chopra. Senator Raphael Warnock (D-Ga) who, as a freshman senator, is Chair of the Banking Committee's Subcommittee on Financial Institutions and Consumer Protection, asked about student loans and protections for military servicemembers. With respect to student loans, Chopra said families of color have a greater need to borrow and then, after graduation, face a wage gap. Chopra said that it is "critical that we get this right." On the question of foreclosures against servicemembers, Warnock recalled that some servicemembers had to fly home from their deployments to try to save their homes. Chopra said how an institution treats servicemembers can be a canary in the mine.

Senator Jon Ossoff (D-Ga) asked if bailouts are a form of regulatory capture. Chopra said the Dodd-Frank Act was an effort to eliminate the too-big-to-fail approach to bailouts. Chopra also suggested that a modernized payments system could help. Ossoff then asked about non-banking entities like Walmart seeking to enter the banking field. Chopra noted that such business model pivots were not at the core of what the CFPB does, but he added that when non-traditional banking entities or large technology platforms become involved in new services like banking that can raise questions about anti-money laundering compliance, privacy, and other issues. Chopra also said the dominant players should not be able to squelch competition.

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