Securities Regulation Daily Wrap Up, SEC NEWS—Amid intense criticism, Gensler defends SEC's rulemaking in Senate Banking Committee hearing, (Sept. 12, 2023)

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By Suzanne Cosgrove

The SEC chief also had harsh words for the crypto industry: "I've been around finance for 44 years, and I have never seen a field so rife with misconduct."

The lone witness in a Tuesday hearing on SEC oversight held by the Senate Committee on Banking, Housing and Urban Affairs, SEC Chairman Gary Gensler defended the Commission's rulemaking output, was resolute in his criticism of fraud in the digital-asset industry, explained the reasoning behind the SEC's recent rule requiring private fund advisers to provide more disclosure to investors, and talked about the regulatory challenges of AI.

He also said several times in response to senators' questions about SEC's proposed climate change disclosure rules that the agency does not want to be a climate regulator but is trying to bring consistency to reported climate-related data.

"The SEC has no role as to climate risk itself," Gensler said in his prepared remarks. "We, however, do have an important role in helping to ensure that public companies make full, fair, and truthful disclosure about the material risks they face."

"We oversee public companies, that's it," Gensler said. "And 80 percent of them already make climate control disclosures." The rulemaking is about bringing comparability "to that which is already happening," he said.

Rulemaking and innovation. Gensler noted that the SEC laid out a unified regulatory agenda two years ago and, in the interim, has made 47 proposed and 22 final rulemakings since he became chairperson – a pace for finalized rules that is actually slower than several of Gensler's SEC predecessors in a comparable timeframe.

Nonetheless, several Republican senators blasted the SEC for, as Sen. Tim Scott (R-S.C.) put it, "pumping out regulation" without justification. Under your rule, 'regulation, not innovation' is the preferred choice," Scott said. "Sadly, the agency has fallen short in terms of transparency."

Seeking efficiency. "Key aspects of our rules for the national market system haven't been updated since 2005," Gensler said. "Yet so much has changed. Not only have we seen the electrification of markets, but also a significant share of the markets has moved to wholesalers and other means of trading off exchange, otherwise known as the dark markets."

Gensler noted the Commission put out for comment several proposals that update SEC rules. The proposed changes include a best execution standard rule that would cover all securities markets, including equity, fixed-income and crypto asset securities, and one modernizing the 23-year-old Rule 605, which requires FINRA to make certain order execution information available.

Too fast or too slow? Some senators also criticized Gensler for not allowing enough time for the public to comment on the Commission's proposals. In response, he said the Commission has allowed the public an average of 70 days to comment from the time a proposal is published on the SEC website. Since January 2022, the SEC has provided a minimum of 60 days for comment, with some proposals given a comment period of as long as 100 days from the day a proposal is posted, he said.

Of the 22 SEC rules that were recently approved, nearly all of them were changed from what was originally proposed following public input, Gensler added.

Sen. Elizabeth Warren (D-Mass.) took an opposite view of the SEC's pace. It's "time for you to get this job done" on climate-related rules, she told Gensler.

In addition, while some senators suggested recent SEC rulemaking on private funds went too far, Warren said the Commission did not go far enough in preventing "private equity's most abusive tactics."

"The SEC is carefully regulating a public market that handles only about one in four new investment dollars, while three out of four (dollars) are going into a private market that has much weaker rules," she said.

Crypto fraud litigation. Turning to the cryptocurrency markets, Gensler said he had never seen a field "so rife with misconduct." Given this industry's noncompliance with securities laws, "it's not surprising that we've seen many problems in these markets," Gensler said in prepared testimony. "There is nothing about the crypto asset securities markets that suggests that investors and issuers are less deserving of the protections of our securities laws."

Nonetheless, Sen. Kyrsten Sinema (I-Ariz.) alluded to "recent legal setbacks for the agency, particularly in respect to cryptocurrency," presumably a reference to the D.C. Circuit Court's ruling against the SEC on Grayscale Investment's proposed bitcoin exchange-traded product. Sinema then asked how the SEC has assessed its litigation risk "with respect to the breadth of its rulemaking strategy."

"We take Congress' mandates to us, and the authorities we have, very seriously, but also how the courts interpret that," Gensler replied.

AI's current challenges. Gensler noted the SEC put out a proposal in July to require firms to analyze conflicts of interest that could emerge when using predictive data analytics when interacting with investors. Firms would need to identify any such conflicts that places the firm's interests ahead of investors' interests, then eliminate or neutralize the effects of those conflicts.

In response to questioning, Gensler said the SEC was "technology neutral," and the Commission already uses machine learning, or AI, in certain functions. But AI models, and the biases within them, are hard to explain, he said. AI's new challenges," might be something Congress may need to take up," he added.

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