BETTER MARKETS

The Securities And Exchange Commission: Regulation And Enforcement In 2022

Major Progress But More Work To Do

February 1, 2023

The SEC's Mission and Why it Matters

The SEC is critical to maintaining the integrity, stability, and vitality of our securities markets, and those markets are critical to a thriving economy. They provide funding to companies of all types and sizes, which can expand, create goods and services, and fuel the real economy.

The SEC's responsibility is to write and enforce strong rules to ensure that the securities markets are fair, transparent, and stable. If the SEC falls down on the job, investors suffer fraud and abuse and the markets are more vulnerable to dangerous instability. And if investors lose confidence in the integrity and stability of the securities markets, then they pull back, ultimately threatening the vitality of capital formation and the prosperity of all Americans.

That's why the SEC prioritizes investor protection and, for example, requires companies to disclose complete and accurate information about investment opportunities. That's also why the SEC serves as the federal cop on the securities beat. It is the main line of defense against the financial firms and individuals who commit fraud and other forms of abuse that victimize investors.

Given the SEC's important role, we've taken a look back at the agency's work over the past year on two fronts, **regulation** and **enforcement**. Our report shows that the agency deserves high marks for many of its priorities and achievements, although it also reveals areas where the SEC must do more to fulfill its statutory duty and serve the American public.

REGULATION

1. INVESTOR PROTECTION

The SEC is using its existing authority under the securities laws to combat the unregistered and fraudulent **crypto offerings** that have proliferated over the past several years. Meanwhile, some firms are using new **digital engagement practices** (DEPs) and gamification techniques to induce trading habits that are not in investors' best interest, and the SEC plans new rules targeting those abuses. The SEC recently rolled back rule provisions adopted under the prior administration that hampered the ability of **proxy advisory firms** to provide their clients with timely and independent advice on issues of corporate governance requiring informed shareholder votes. **Mandatory arbitration** has plagued investors for years, forcing them into secretive, unfair, and often expensive forums that provide little relief when they have been victimized by firms. The SEC should exercise the explicit authority it received in the Dodd-Frank Act to ban or limit the use of mandatory pre-dispute arbitration clauses. Advisers continue to give conflicted advice to their clients to generate fees and commissions, and although the SEC has issued helpful guidance and begun to enforce **Regulation "Best Interest,"** it must strengthen the rule itself.

2. MARKET STRUCTURE

The way orders for **securities trades are handled and routed** makes an enormous difference to investors, and the SEC has proposed an ambitious set of rules to make the process fairer and more transparent. They include a new best execution standard, an order competition requirement, smaller trading increments, and enhanced disclosures about how well orders are executed. In addition, to reduce risk, the SEC has proposed to **shorten the "settlement cycle,"** the time period between a trade and the settlement of that trade through the actual exchange of money and securities.

3. FINANCIAL STABILITY

Executive compensation practices that incentivized high-risk financial activities helped set the stage for the 2008 financial crisis. The SEC has recently finalized two important rules, one that will reveal the relationship between **executive compensation and financial performance** and one that will require companies to recover or **claw back incentive-based compensation** that was erroneously awarded, as shown by accounting restatements. The huge market in U.S. **Treasury securities** is a potential source of dangerous financial instability, and the SEC is pursuing new rules to enhance the oversight of trading platforms specializing in government securities, require high-frequency trading firms that trade extensively in government securities to register as dealers, and require more trading in U.S. Treasuries to be conducted through a central clearing agency. The SEC has proposed new liquidity requirements to help make **money market funds** more resilient in times of market stress, although they fall short of the measures needed to fortify these bank-like products, including capital buffers and pricing for all MMFs that accurately reflects the changes in share value (the floating NAV). Finally, the SEC must do more to address the conflicts of interest that dominate the major **credit rating agencies**, which have a history of inflating ratings to attract and retain lucrative ratings business from companies seeking to raise capital. The SEC should establish an independent assignment system for structured products, as required under Dodd-Frank; make clear that the ratings agencies are liable for misleading ratings; and reveal the names of the firms shown to have violated the law in the annual examination reports compiled by the SEC.

4. CAPITAL FORMATION

The **private offering markets** have overtaken the more transparent "initial public offering" process for raising capital. The SEC plans to help restore balance by increasing transparency in the required filings associated with private offerings (the Form D), updating the accredited investor definition to ensure only wealthier investors assume the heightened risks in private offerings, and expanding the universe of companies that must file regular reports with the SEC (via a change to the definition of shareholder "of record"). The SEC has moved aggressively to combat abuses in offerings by **special purpose acquisition companies (SPACs)** through rule proposals and targeted enforcement.

5. ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS

Environmental, social, and governance (ESG) factors are of increasing interest to investors as they decide where to put their money at risk. The SEC is responding with two rules aimed at ensuring that investment fund strategies match **fund names** and enhancing **disclosures** surrounding ESG funds. The SEC has also proposed a wide-ranging rule to require enhanced and standardized corporate **disclosures regarding climate change** risks. To help address racial economic inequality, the SEC has issued FAQs to promote diversity in the asset management field, and it plans to propose a rule requiring disclosures about **corporate board diversity**. To mitigate risk, promote fairness, and enhance corporate transparency, the SEC has proposed rules to strengthen the reporting obligation when the **5% ownership threshold** in a company is reached and to reveal more information about **share buybacks**, often used to enhance executive compensation rather than benefit the company or its workforce.

6. PRIVATE FUNDS

Private investment funds pose stability risks and investor protection concerns. The SEC has appropriately proposed rules to enhance the quantity, quality, and timeliness of private fund reporting on the **Form PF**, and it has proposed a rule that will require more comprehensive **disclosures to investors**, audits, fairness opinions for certain transactions, and bans on preferential treatment of investors.

ENFORCEMENT

The SEC amassed an impressive record of enforcement, with an increase in the number of cases and monetary sanctions totaling $6.4 billion in fiscal year 2022. However, it must be more aggressive if the tide of securities law violations is to be stemmed. The SEC must routinely hold **individuals** accountable, not only their corporate entities; impose **fines** large enough in relation to a defendant's assets or net worth to effectively deter misconduct; and impose more robust **non-monetary sanctions** to reform behavior and protect the public.

The SEC continues to use the **whistleblower program** to good advantage, and it wisely finalized two rules to make clear it will consider the dollar amount of an award only to increase, not decrease, the award, and further to clarify that it is prepared to make awards even if an award could be made under another agency's whistleblower program. Finally, as noted above, the SEC is actively pursuing **crypto violators** under the securities laws, and a compilation of significant cases is set forth in the Appendix.

Learn more in our full report here.

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Better Jobs | Better Economic Growth
Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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