The Legal Intelligencer

What Will the (Securities) Rules Look Like?

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As of Jan. 20, 2017, a new administration took over the White House and Republicans control both Houses of Congress. This power shift raises a number of questions, not the least of which is, what will securities laws and securities law enforcement look like in the coming years? After eight years of the U.S. Securities and Exchange Commission (the SEC) being led by former enforcement regulators and criminal prosecutors, commentators assume that the administration change marks a pivot toward securities deregulation and reduced enforcement.

On Sept. 13, 2016, the House Financial Services Committee of the U.S. House of Representatives formally released H.R. 5983, the "Financial CHOICE Act" (the CHOICE Act). The CHOICE Act has been touted as an alternative to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and offers one perspective on how securities regulation may take shape under the new administration.

The CHOICE Act would repeal much of the Dodd-Frank Act regulatory structure, including disclosure relating to pay ratio and conflict minerals as well as the complete repeal of the Volcker Rule, the Durbin Amendment, the Orderly Liquidation Authority and other major provisions that have been shaping the securities regulatory landscape since the inception of the -Dodd-Frank Act.

Proponents of the CHOICE Act argue that it encourages self-regulation on Wall Street that will "empower Americans" and result in "economic growth." They claim that the CHOICE Act unburdens public companies from the regulatory obligations imposed by the Dodd-Frank Act. Though the CHOICE Act would repeal much of the Dodd-Frank Act, some of its purported goals appear to be the same or similar to those of the Dodd-Frank Act:

• Impose enhanced penalties for fraud and deception on Wall Street. The CHOICE Act would purportedly accomplish this by increasing statutory and civil penalties for violations of the securities laws and giving the SEC discretion to further raise sanctions for violations of the securities laws, however, opponents suggest that the CHOICE Act would repeal all of the critical enforcement mechanisms that currently help to detect and deter fraud and deception on Wall Street. Further, opponents of the CHOICE Act point out that shareholders will ultimately "foot the bill" for these higher penalties.

• Relief for Smaller Issuers and Emerging Growth Companies. The CHOICE Act increases certain exemptions from disclosure requirements to issuers with a market capitalization of up to $250 million and extends the exemption to depository institutions with less than $1 billion in assets. Further, the CHOICE Act would provide an exemption for emerging growth companies and certain other smaller companies from Extensible Business Reporting Language requirements.

• Enhance Small Business Capital Formation. The CHOICE Act would amend Section 503 of the Small Business Investment Incentive Act by requiring that the SEC review the findings and recommendations of the Government-Business Forum on Capital Formation (the forum) and, each time the forum submits a finding or recommendation to the SEC, promptly issue a public statement that assesses the findings or recommendations of the forum and discloses the action, if any, the SEC intends to take with respect to the findings or recommendations.

Opponents of the CHOICE Act protest that it would result in the type of deregulation that led to the economic downturn in 2008. These opponents are concerned that the CHOICE Act will erode any semblance of transparency on Wall Street, which would dramatically harm the economy, again. Some aspects of the CHOICE Act appear to be in direct conflict with certain policies under Dodd-Frank:

• End "too big to fail" bank bailouts. Among other things, the CHOICE Act would repeal the authority of the Financial Stability Oversight Council (FSOC) to designate non-bank financial companies as systematically important financial institutions, and retroactively repeal its previous designations of non-bank financial companies. Further, the CHOICE Act would repeal Title VIII of Dodd-Frank, which gives the FSOC authority to designate certain payments and clearing organizations as systemically important "financial market utilities" with access to the Federal Reserve discount window, and retroactively repeal all previous financial market utility designations.

• Revisions to the Prohibition Against General Solicitation and Advertising. The CHOICE Act would require the SEC to revise Regulation D under the Securities Act of 1933 (Reg D) to require that the prohibition against general solicitation or general advertising contained in Rule 502(c) of Reg D does not apply to certain presentations made at business fairs.

In addition, there are a handful of provisions in the CHOICE Act that would render the SEC's ability to conduct rulemaking much more difficult. One such provision, proposed Section 631, would require a joint resolution of Congress before the SEC could engage in any "major" rulemaking. Opponents of the CHOICE Act point to provisions such as Section 631 as evidence that the CHOICE Act is infusing partisanship into the processes of a traditionally independent agency. In addition, provisions such as Section 631 will stymie the SEC's autonomy and ability to take swift action when regulation, or deregulation, is needed.

While the CHOICE Act may drastically change the securities regulatory landscape, the CHOICE Act will take time to adopt and implement. As a result, the short-term impact of the new administration's securities regulation agenda will be measured in the way that the new administration enforces the current securities regulations.

Though the new administration has been enigmatic with respect to certain enforcement policies, it has provided clear evidence that it intends to relax enforcement with respect to the current securities regulations with its appointment of Wall Street lawyer, Walter "Jay" Clayton to the SEC. If confirmed by the Senate, Clayton would replace Mary Jo White, who announced shortly after the election that she will step down. Most commentators have characterized Clayton's appointment as a signal that, in addition to deregulating Wall Street, the new administration will "shift away from enforcement" of the securities laws.

The SEC was created as an independent federal regulatory agency. Its commissioners over the years have been chosen for their expertise and have come from various backgrounds and geographical regions. Clayton's appointment signals a move toward partisan appointments that will ensure that the SEC's agenda is aligned with the executive and legislative branches' plans for securities regulation. Marcus Stanley, policy director for Americans for Financial Reform, has said, "Mr. Clayton's background is as a Wall Street defense lawyer—and while that's hardly unprecedented in these kinds of nominations, we believe it's not the appropriate background for a top position policing Wall Street." The new administration will have two additional vacancies to fill on the SEC. As reflected in Stanley's comment, some are concerned that if the new administration's other two appointments to the SEC are similar to Clayton that the SEC could lose credibility as an independent regulatory agency, whose commissioners are chosen for their expertise.

Clayton's appointment, along with some of the other cabinet choices that have been announced by the new administration, could impact the SEC's agenda by encouraging, among other things, the following:

• A re-evaluation of proposed rules relating to restricting incentive-based compensation arrangements;

• A change in the SEC's generous reward program for whistleblowers and initiatives to curtail whistleblowing activities; and

• A reduction in the SEC's reliance on administrative actions, which has been criticized by members of the new administration as lacking due process.

Both the CHOICE Act and the new administration's first SEC appointment suggest that the new administration and Congress will dial back securities regulations, many of which were enacted in response to the 2008 financial crisis.

How should companies prepare? Companies subject to the securities laws should pay especially close attention to the SEC's agenda for the coming year and should stay abreast of legal alerts relating to the evolving securities laws. Companies should also remain compliant with the current securities regulations, because the SEC's enforcement policies remain uncertain.

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