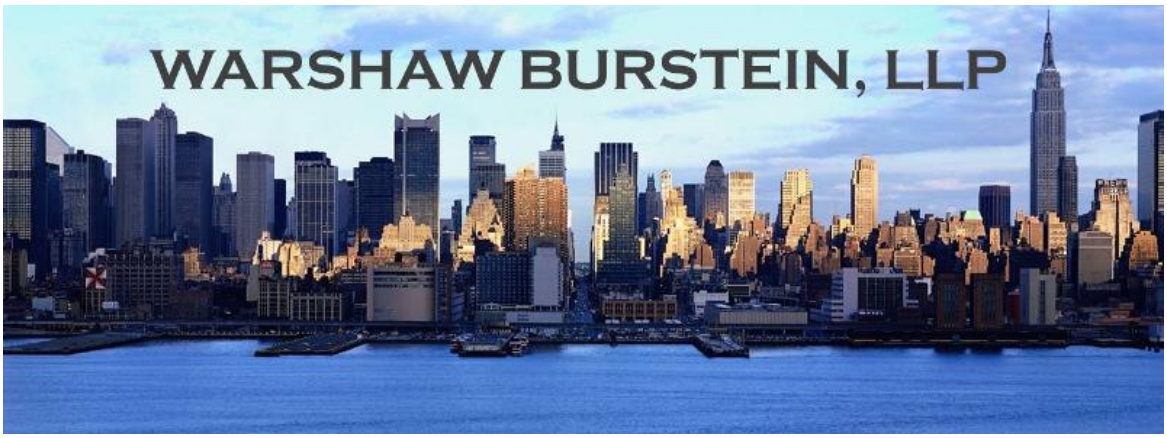
March 11, 2015



CLIENT ALERT

THE SEC SPEAKS IN 2015

At the annual *SEC Speaks* Conference held on February 20 and 21, 2015 in Washington, D.C., the Chair of the Securities and Exchange Commission (the "SEC") and each of the Commissioners addressed the several hundred attendees and expressed his/her views on the record of the SEC in 2014 and his/her priorities for the year 2015. The staff of various SEC divisions and offices, including Trading and Markets, Investment Management, Enforcement, Compliance Inspections and Examinations, Corporation Finance, Accounting and Economic and Risk Analysis, reviewed many of the tasks undertaken and accomplishments of their respective divisions/offices in 2014 and the initiatives contemplated for 2015.

To provide a flavor of the Conference, we will summarize the presentations of the Chair and the other Commissioners. We will not summarize the speeches of the staff, but based on the presentations as a whole, it appears that going forward, the SEC will increase its emphasis on enforcement, with the benefit of continuing technical and analytical sophistication, and will conclude the rulemaking mandated by The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

Chair Mary Jo White

In her address, Chair White noted the completion in 2014 of "several transformative rulemakings, including new policy reforms to address faults exposed during the financial crises and initiatives to better address vulnerabilities in the resiliency and integrity of [our] markets." [1] She also noted the increase in enforcement matters, plans for optimizing the structure of the equity and fixed income markets, enhanced risk supervision of the asset management industry, bolstered effectiveness of public company disclosure and the strengthening of examination coverage of market participants. She mentioned various reforms the SEC adopted to promote

[1] The full text of Chair White's address is available at http://www.sec.gov/news/speech/2015-spch022015mjw.html#.VP3DqPnF_jU.

financial stability for the protection of investors and to strengthen the markets to correct weaknesses laid bare by the financial crisis of 2008.

Chair White highlighted that both the number of cases brought (755) and the monetary relief ordered ($4.1 billion) was the largest ever recorded by the SEC. She pointed out that in 2014, the SEC "focused on innovative, high impact cases and punished and deterred wrongdoers in a way that sent important messages to the market, including by obtaining more admissions to achieve heightened accountability and acceptance of responsibility from entities and individuals." These cases included many "first-of-their-kind" cases that expanded the SEC's enforcement footprint. She emphasized that enforcement "is focused on cases involving violations where market participants fail to provide a level playing field in the securities markets."

In the area of examinations, Chair White observed a 15% increase in 2014 over 2013 of the number of registrants examined by the Office of Compliance Inspections and Examinations ("OCIE"), using its National Exam Analytics Tool ("NEAT") to better detect potential suspicious activities and narrow the scope of examinations to areas that pose the greatest risks. She specifically mentioned a cybersecurity sweep the SEC undertook to assess cyber preparedness within the broker-dealer and investment adviser communities.

Chair White concluded her remarks by highlighting the SEC's core initiatives for 2015, namely, to (a) improve the structure and operations of the U.S. equity markets; (b) address risks that could have a systemic impact on the markets or the financial system as a whole; and (c) facilitate capital formation for smaller issuers (including implementing two major mandates of the Jumpstart Our Business Startups Act ("JOBS Act") – Regulations A+ and crowdfunding). Other important priorities Chair White mentioned include considering whether to adopt a uniform fiduciary duty standard for broker-dealers, reviewing disclosure effectiveness, reviewing the definition of "accredited investor," exploring ways to increase exam coverage of investment advisers, enhancing broker-dealer financial responsibility rules and updating the regulatory regime for transfer agents.

Commissioner Luis A. Aguilar

Commissioner Aguilar laid out several priorities he believed the SEC should pursue in 2015, including completing rulemaking mandated by Dodd-Frank, continuing implementation of the JOBS Act, bringing enforcement cases that send a strong message of deterrence and improving diversity at the SEC.[2]

Commissioner Aguilar was critical of SEC rulemaking, stating that of the 97 separate rulemakings mandated by Dodd-Frank, the Commission finalized only 56 of the rules. He said that the Commission's failure to finalize these rules creates a "regulatory limbo" that impedes business. He noted that rulemaking relating to derivatives regulation and corporate governance is particularly lacking, specifically citing "rules on disclosures about pay-for-performance, the disclosure ratio between the CEO's compensation and the median of all other company

[2] The full text of Commissioner Aguilar's address is available at http://www.sec.gov/news/speech/022015-spchclaa.html#.VP3D3PnF_jU.

employees, disclosure by large investment managers of their "say-on-pay" votes, and prohibiting the exchange listing of securities of issuers that have not implemented claw-back policies."

Commissioner Aguilar expressed concern regarding the failure to implement rules that would facilitate the ability of smaller businesses to access the capital markets, mentioning in particular the need to adopt final rules to Regulation A+, crowdfunding and to amend Regulation D to mitigate risks posed to investors involved in general solicitations. In this connection, Commissioner Aguilar highlighted various "macro" principles to be kept in mind in connection with implementing JOBS Act provisions, including: (a) the nature and experience of the investor investing in any particular offering and whether a particular offering should be limited to only certain types of investors; (b) the type of information necessary to permit targeted investors to make informed investment decisions; (c) the overall regulatory environment in protecting investors and promoting capital formation for smaller offerings; and (d) consideration of the secondary trading environment that may exist as more companies distribute their shares to a wider swath of investors. Commissioner Aguilar warned against inappropriately weakening the regulatory environment by granting excessive exemptions that by their nature "strip investors of protections."

Regarding enforcement matters, Commissioner Aguilar reiterated his views regarding the various tools available to the SEC when fraud has occurred, including the ability to seek to enjoin the fraudulent activity, disgorge ill-gotten gains, impose civil penalties and impose trading suspensions and asset freezes. But, he said, the "most potent" remedy is for the SEC "to prevent wrongdoers from being allowed to remain in a role that permits them to continue to hurt investors," and called on the SEC to be more aggressive in seeking permanent industry, and officer and director bars, especially against recidivist violators. He stated that bars and taking "fraudsters" out of the industry often have a far more lasting impact than imposition of a monetary fine – a penalty that companies are far more willing to treat simply as a cost of doing business.

Finally Commissioner Aguilar urged the SEC itself to improve the diversity in its workforce to better reflect the communities it serves.

Commissioner Daniel M. Gallagher

Commissioner Gallagher expressed concern that over the past several years there has been much "chipping away at the one hundred or so mandates" imposed on the Commission by Dodd-Frank and that the SEC is "not even halfway done" implementing its Dodd-Frank mandates.[3]

Commissioner Gallagher expressed concern regarding rulemaking currently being re-proposed by the Department of Labor ("DOL") with respect to the definition of the term "fiduciary" and to a uniform fiduciary duty standard for broker-dealers and investment advisers. He is concerned that a uniform fiduciary duty for broker-dealers and investment advisers could harm retail investors because it "could limit financial advisory options or preclude investors from receiving investment advice altogether." He stated his belief that the DOL's rulemaking

[3] The full text of Commissioner Gallagher's address is available at http://www.sec.gov/news/speech/022015-spchcdmg.html#.VP3D_vnF_jU.

endeavor is related to a premise – one he considers unproven – that the "entire SEC-regulated industry is plagued by conflicts of interest." He is against an approach that would regulate conflicts of interest by banning them, as opposed to the approach he prefers, namely, "to mitigate potential risks associated with conflicts through market rules, disclosure, compliance and enforcement" (the present approach of the securities laws). Commissioner Gallagher stated that in his view, investors "benefit from choice, choice of products, and choice in advice providers." He expressed concern that banning conflicts will eliminate entire categories of products and services that are available to investors. Commissioner Gallagher advocated "a regulatory system that balances mitigating conflicts and effective disclosures with expanding investment of opportunities for the good of individual investors and the economy as a whole."

Commissioner Gallagher closed by stating that "while being a 'fiduciary' means acting in the best interest of a client," it does not mean that all models where financial professionals are *not* fiduciaries are flawed." He expressed concern that labeling all financial professionals as "fiduciaries" is an attempt at "one size fits all regulation," which ends up as "one size fits none." He reiterated his belief that conflicts exist, but that "investors and our markets are better off when we seek to manage those conflicts, through disclosures or otherwise, rather than eviscerating entire business models and the benefits they provide."

Commissioner Kara M. Stein

Commissioner Stein began her address with a brief retrospective on the securities industry, noting that "advances in technology and communication have forever transformed the landscape of our securities marketplace."[4] She observed that electronic trading venues have proliferated and that trading volumes have increased exponentially. She focused on three topics connected to what she termed a "rapidly evolving landscape," namely, (a) how to reimagine disclosure and data to keep pace with a digitized and data-centric market; (b) how technology has increased complexity; and (c) the importance of a culture of compliance.

Regarding disclosure, Commissioner Stein queried whether technology could enable a new way of communicating with investors. She lamented that in a "data-centric world of nanoseconds," the SEC disclosure regime has not changed much. For example, she noted that the EDGAR system that was launched in 1955 – which replaced paper documents with electronic documents that can be accessed over the Internet – has not changed much in the last 20 years. She stated her belief that modernizing the "critical disclosure portal" should be a top priority. She made the innovative suggestion that investors should be able to request and direct the particular type and quantity of data they receive – some investors want to know the basics only, while others want more detailed information and should be able to "drill down to get that detail." She stated her belief that making data available more quickly and in a format more usable "could enable better decision-making, empowering both investors and market participants."

Another topic addressed by Commissioner Stein was complexity. She observed that technology and the digital revolution have facilitated the "explosion of exotic, synthetic and difficult to understand financial products," noting that "complexity upon complexity does not enhance capital formation." She also expressed concern that "complexity can mask the

[4] The full text of Commissioner Stein's address is available at http://www.sec.gov/news/speech/022015-spchckms.html#.VP3EGPnF_jU.

interconnections between firms" and suggested focusing on ways to improve the transparency of those interconnections.

Commission Stein expressed concern about investor protection. She advocated that the tool of automatic disqualifications ("bad actor" bars) should be used as a deterrent to reinforce compliance. She stated that she does not see the bar as a "punishment," but rather as a deterrent, especially in the case of recidivism. She expressed her view that a "bad actor" bar provides a "forward-looking or prophylactic tool, designed to deter and prevent recidivism and restore trust in the markets."

Commissioner Stein stated that the argument that the SEC "should grant a waiver whenever the reason for automatic disqualification is 'unrelated' to the waiver defies common sense." She stated that she does not "view automatic disqualifications as a tool for protecting investors or ensuring fair and orderly markets. Effective application of bad actor bars is *fundamental* to facilitating capital formation as well. Capital formation depends on trust." She reiterated the need to bring transparency and consistency to the waiver process.

Commissioner Stein concluded with the well-known SEC mantra that "problems of compliance start and end at the top."

Commissioner Michael S. Piwowar

Commissioner Piwowar stated that as the SEC considers what it can do to carry out its mission effectively "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," it must consider how the SEC itself can be more "fair, orderly, and efficient."[5]

On the subject of a more "fair" agency, Commissioner Piwowar stated that just as the backbone of the securities laws is disclosure, so too, the SEC should provide sufficient information to market participants about how they will be impacted by SEC decisions and clear guidelines ensuring that SEC regulations are applied consistently.

In the realm of rulemaking, he remarked that those being regulated must know the rules and standards to which they will be held, and that any rulemaking must be on proper notice coupled with an opportunity for the public to comment. He explained that this means the SEC "must not engage in rulemaking by enforcement or through examinations of regulated entities." He expressed concern about the SEC staff succumbing to the temptation "to include undertakings in enforcement settlements or principles in examination reports that serve as *de facto* rule requirements."

In the realm of litigation, he stated his view that the SEC should adhere to consistent guidelines when conducting enforcement proceedings. Commissioner Piwowar was critical of the Commission's recent indication that it would recommend instituting more enforcement matters (including insider trading cases) through administrative proceedings, rather than going through federal district courts. His concern was that in administrative proceedings, there is no jury, administrative law judges are employees of the SEC and discovery is more limited. He

[5] The full text of Commissioner Piwowar's address is available at http://www.sec.gov/news/speech/022015-spchcmsp.html#.VP3EOvnF_jU.

recommended that the Commission set out clear guidelines for determining which cases are brought in administrative proceedings and which in federal courts. Also in the litigation context, he stated that there should be consistent applications of publicly stated guidelines regarding imposition of corporate penalties and issuance of waivers.

Regarding a more "orderly" agency, Commissioner Piwowar cautioned about the need for prioritization in the rulemaking, enforcement and examination contexts, and expressed dissatisfaction with the "broken windows" approach, especially in enforcement matters. He stated that enforcement efforts should be closely aligned with priorities developed by the SEC's policy-making divisions, all of which should be geared to the core mission of the SEC: "protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation." He complimented the SEC's examination program, and specifically OCIE, for setting priorities as to which entities should be inspected and for basing those priorities on heightened risk. He also noted that while much progress had been made in timely processing exemptive applications, much work still needed to be done. He expressed his view that if priorities were better organized, there would be less need for exemptive applications and processing the applications could be done on a more timely basis.

Regarding a more "efficient" agency, Commissioner Piwowar noted, approvingly, the SEC's deployment of its resources into strategic investments in cutting-age technology. He also noted, again approvingly, the SEC's internal reorganizations, mentioning specifically, the reorganization of the Division of Enforcement into five national specialized units (Asset Management, Market Abuse, Complex Financial Instruments, Foreign Corrupt Practices and Municipal Securities and Public Pension Trusts). To further increase efficiency, Commissioner Piwowar suggested increasing the use of investor testing, pilot programs and retrospective reviews of existing rules. He thought these could "help us determine weaknesses in our current disclosure requirements as well as what information would be most helpful to investors and in what format. Pilot programs, such as the one that we are currently considering to assess stock market tick size impact for smaller companies, enable us to test hypotheses and use the results to determine whether change is needed without causing harm to investors." He also advocated engaging with academia, attorneys and others outside the securities industry and tapping into their outside expertise to help identify rules that should be modified or repealed for the purpose of making the SEC's regulatory regime more effective in achieving its core mission.

Conclusion

While the Chair and the Commissioners articulated various personal priorities for the SEC in 2015, they and the staff were in agreement that the SEC is a hardworking, well-meaning agency that takes very seriously its core mission to protect investors and maintain a fair, orderly and efficient market.

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If you have any SEC or securities-related questions, please contact Meryl Wiener, any of the undersigned or your regular Warshaw Burstein attorney.

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