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## SEC Congressional Testimony- Part I

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

On three occasions recently representatives of the SEC have given testimony to Congress. On March 24, 2015, SEC Chair Mary Jo White testified on “Examining the SEC’s Agenda, Operations and FY 2016 Budget Request”; on March 19, 2015, Andrew Ceresny, Director of the SEC Division of Enforcement, testified to Congress on the “Oversight of the SEC’s Division of Enforcement”; and on March 10, 2015, Stephen Luparello, Director of the Division of Trading and Markets, testified on “Venture Exchanges and Small-Cap Companies.” In a series of blogs, I will summarize the three testimonies. This first blog in the series summarizes the testimony of Mary Jo White.

### **Mary Jo White Testimony**

On March 24, 2015, SEC Chair Mary Jo White gave testimony before the United States House of Representatives Committee on Financial Services. The testimony was titled “Examining the SEC’s Agenda, Operations and FY 2016 Budget Request.” As can be gleaned from the title, Mary Jo White was giving testimony in support of her request for additional funding and approval of the SEC FY 2016 budget. The testimony is a good summary of the areas of focus and concern to the SEC, both in the past and coming year, and a summary of the different efforts of the departments within the SEC. Ms. White’s testimony is basically an SEC overview.

Ms. White began her testimony by summarizing the various rule-making initiatives of the SEC over the prior year, including: (i) new rules related to enhanced offering disclosure requirements for asset-backed securities; (ii) rules reducing the importance of credit rating agencies, including the removal of references to such agencies in 30 rules and forms; (iii) rules governing money market funds; (iv) new rules regulating security-based swaps; (iv) additional rules implementing the JOBS Act, including increasing the

threshold for registration under Section 12(g) and the new Regulation A rules (which came out the day after the speech but were mentioned); (v) a rule requiring sponsors of securitization transactions to retain risk in those transactions; (vi) adoption of Regulation Systems Compliance and Integrity creating mandatory technology and systems standards and reporting for certain market participants; and (vii) proposed rules related to disclosure of hedging policies by officers and directors.

She continued with a summary of the focus on, and measures taken related to, the U.S. equity market structure. The SEC is examining the effect of tick size on the quality of markets and has supported studies on transaction types and information processors including data feeds, all of which can affect market efficiencies and capital raising efforts. The SEC has created an equity market advisory committee to review the structure and operations of the U.S. equities market and provide a formal mechanism for the SEC to receive advice and recommendations related to the equity markets. The advisory committee's focus, under the director of the SEC Chair, is on "high frequency trading and fairness, market transparency, trading venue regulation, mitigating broker conflicts, and critical market infrastructure." Also related to equity markets, the SEC is pursuing the improvement of trading of fixed income securities, including bonds.

On the enforcement front, the SEC filed 755 enforcement actions and obtained more than \$4.16 billion in disgorgement and penalties in 2014 and has utilized data analytics to increase its examinations and enforcement efforts. In the coming year the SEC plans to continue to rely on technology and data analytics and algorithms to detect fraud and suspicious behavior.

Other technological initiatives by the SEC in the coming year will be (i) EDGAR modernization to simplify filing and the costs of filing; (ii) Examination Improvements to improve risk assessment and surveillance and, in particular, fraud detection; and (iii) Enterprise Data Warehouse, which is a centralized repository for the SEC to maintain and organize its tremendous amounts of data, and provide public access to such data in usable formats.

The SEC regulates over 25,000 market participants, including broker-dealers, investment advisers, transfer agents, exchanges, and others. She adds that the SEC has "an immediate and pressing need for additional resources" to continue and expand its regulatory efforts while promoting regulatory growth.

The testimony then continues with a highlight of each of the SEC Divisions efforts including continued efforts on rule making for both the Dodd-Frank Act and JOBS Act. A summary follows.

### **Issuer Disclosure and Capital Formation**

The Division of Corporation Finance is responsible for reviewing annual and periodic reports as well as all specialized issuer filings such as registration statements and proxy materials. In addition, the Division of Corporation Finance is responsible for various rule making initiatives including Dodd-Frank rules related to accredited investors, say on pay, asset-backed securities, conflict minerals, and bad actor disqualifications. The Division of Corporation Finance is also responsible for JOBS Act rule making including Rule 506(c) and the new Regulation A and for conducting numerous studies required by the JOBS Act, including a review of the disclosure rules contained in Regulation S-K. The Division is currently developing recommendations for updating the disclosure requirements to improve effectiveness and reduce duplication.

### **Trading and Markets**

The Division of Trading and Markets supervises the major participants in the securities markets, including securities exchanges, broker-dealers, clearing agencies, transfer agents, FINRA, security futures product exchanges, and securities information processors. Like the Division of Corporation Finance, the Division of Trading and Markets has significant rule-making responsibilities, including rules related to oversight of the OTC derivatives marketplace (swaps) as required by Title VII of the Dodd-Frank Act.

In addition, the Division of Trading and Markets is utilizing the depth of new data and technology available to the SEC to study the trading markets and make recommendations and rule-related proposals including those related to off-market registration requirements for broker-dealers, risk management algorithms, disclosure requirements for alternative trading systems (ATs), anti-disruptive trading rules and a proposed rule regarding the status of active proprietary traders as dealers.

Moreover, the SEC continues to review the impact of tick size for the quoting and trading of equity securities of smaller companies. The SEC recently assisted in the adoption of the Volcker Rule regulating bank investment activities. Pursuant to Section 913 of the Dodd-Frank Act, the SEC is considering imposing a uniform fiduciary

standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers.

### **Oversight of Investment Funds and Managers**

The SEC's Division of Investment Management is responsible for disclosure and regulatory functions related to mutual funds, other investment companies and investment advisors. In July, 2014 the SEC adopted reforms governing money market funds intending to reduce the risk of runs in the funds and enhance transparency. Among other changes, under the new rules, "institutional prime" money market funds will be required to maintain a floating net asset value based on the current market value of the securities in their portfolios. Money market funds will be required to disclose additional key information on their website on a daily basis, including funds' liquidity levels, net shareholder flows, and market-based net asset values per share. The Division of Investment Management has also formed a new risk and examinations office (REO) to monitor the asset management industry.

### **Economic Analysis, Risk Assessment and Data Analytics**

The Division of Economic and Risk Analysis performs sophisticated analyses of economic, financial, and legal disciplines with data analytics and quantitative methodologies. Ms. White reports that this is the fastest-growing division within the SEC. The Division of Economic and Risk Analysis conducts data analytic analysis for all of the divisions of the SEC to examine the need for regulatory action, participates in such regulatory initiatives and conducts investigations. The Division has also established a new Office of Risk Assessment for the purpose of providing financial and risk modeling expertise to other offices and divisions to support supervisory, surveillance, and investigative programs related to corporate issuers, broker-dealers, investment advisers and exchanges and trading platforms. Based on Ms. White's recent public statements, including the herein summarized speech to Congress, the area of technological data analytics is of prime importance to her and the foundation for most of the SEC's ongoing initiatives.

### **Enforcement**

In 2014 the SEC brought the highest number of enforcement actions in its history. The SEC, under Ms. White, has increased its areas of active enforcement, bringing many first-time actions. The SEC has increased enforcement activities against market

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participants such as broker-dealers and exchanges. Ms. White also touts the SEC's relatively new policy of requiring admissions of guilt as part of settlements. Further, the SEC's whistle-blower program has led to many significant enforcement actions and has increased the ability of the SEC to receive quality inside information regarding violations.

### **Inspection and Examination Program**

The Office of Compliance Inspections and Examinations examines securities firms registered with the SEC, including broker-dealers, municipal securities dealers, SROs, clearing agencies, transfer agents, investment advisers, and investment companies. The Dodd-Frank Act increased its responsibilities to include examinations of, among others, municipal advisors, investment advisers to certain private funds, security-based swap dealers, security-based swap data repositories, major security-based swap participants, and securities-based swap execution facilities. Like other divisions of the SEC, the Office of Compliance Inspections and Examinations utilizes data analytics and technology to identify and investigate potential security law violations or market issues.

### **Office of Credit Ratings**

The Office of Credit Ratings, which was first established by the Dodd-Frank Act, administers the rules related to national statistical rating organizations, including conducting studies to determine the feasibility and desirability of standardizing ratings and imposing new and more robust regulations related to the rating process. Although Ms. White did not address the issue in her speech, it is widely believed that the improper rating of mortgage-backed bonds and funds was one of the prime factors in the financial crisis precipitating the enactment of the Dodd-Frank Act.

### **Office of the Investor Advocate**

The Office of Investor Advocate was also first established by the Dodd-Frank Act and created in February 2014. The purpose of the Office is to provide input on behalf of investors related to policies and rule making by the SEC.

### **Office of Minority and Women Inclusion**

The Office of Minority and Women Inclusion is responsible for all matters related to diversity in management, employment, and business activities at the SEC. The Office is

responsible for developing standards for ensuring equal employment opportunity and diversity in the workforce and senior management of the SEC, increasing the participation of minority-owned and women-owned businesses in the SEC's contracting, and assessing the diversity policies and practices of entities regulated by the SEC.

### **Office of Municipal Securities**

The Office of Municipal Securities administers the SEC's rules pertaining to municipal securities broker-dealers, municipal advisors, investors in municipal securities, and municipal issuers and coordinates with the MSRB on rule making and enforcement actions and generally advises the SEC on matters related to the municipal securities market.

### **Office of International Affairs**

The Office of International Affairs develops and implements strategies to further SEC interests in the regulation and oversight of cross-border securities activities, advances cross-border enforcement and supervisory cooperation, and provides technical assistance to strengthen global financial markets. The Office also advises the SEC on the implementation of SEC initiatives that have an impact beyond the United States, and on foreign and global initiatives that may impact the agency, the U.S. market, and U.S. market participants.

### **Office of Chief Accountant**

The Office of Chief Accountant is the SEC's main adviser on accounting and auditing matters and oversees the Financial Accounting Standards Board (FASB) and the Public Company Accounting Oversight Board (PCAOB) as related to public company accounting.

### **Office of Investor Education and Advocacy**

The Office of Investor Education and Advocacy is responsible for preparing and issuing investor information and in particular relating to fraud prevention, and responding to complaints and inquiries.

## Internal Operations

The Office of the Chief Operating Officer is responsible for the internal operations and human resources of the SEC.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, The Securities Law Network.

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