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PERSPECTIVE

The SEC after Obama & White

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With SEC Chair Mary Jo White's announcement earlier this month that she will be stepping down around the same time as President Barack Obama leaves the White House in January, there has been much speculation about how the Securities and Exchange Commission might operate differently during the Trump administration. In addition to replacing White, President-elect Donald Trump will have the opportunity to fill the two other current vacancies on the five-member commission, setting the stage for a fundamental change in direction.

Dismantling Dodd-Frank

An obvious place for change is Dodd-Frank, the statute Trump said during the campaign he would be "close to dismantling." But which parts might go and which might remain? As former SEC Commissioner Paul Atkins, the member of Trump's transition team tasked with financial regulatory issues, pointed out in a speech last year, Dodd-Frank "is 2,319 pages long and contains demands for more than 500 new rules and studies, which have produced so far tens of thousands of pages of regulations. Despite a once-in-alifetime opportunity to streamline our crazy quilt of financial services regulators, the Dodd-Frank authors blew it." As subjects for reform go, Dodd-Frank is a target- rich environment.

While it is too early to tell how and to what extent the Trump administration will "dismantle" Dodd-Frank, one prime Dodd-Frank target is the provision that permitted the SEC to file any enforcement action before its own administrative law judges (before whom the Division of Enforcement has had a decided advantage), as opposed to federal courts. Prior to Dodd-Frank, the SEC was limited in the types of administrative cases it could file to those involving registered investment professionals or entities and respondents who consented to settled administrative actions. The SEC's decision to file an administrative action denies certain procedural rights to respondents that they would enjoy in federal court, such as broader discovery rights and jury trials. For these reasons, this provision has become one of the more controversial provisions of Dodd- Frank and has been roundly criticized by judges, defense lawyers, and even former commissioners.

The SEC has been largely deaf to this criticism. Indeed, the director of the Division of Enforcement announced the division's intention to file more administrative cases in June 2014 after the SEC had suffered a string of high-profile jury trial losses. The timing of the announcement gave the unfortunate impression that the SEC preferred to litigate in SEC-friendly administrative hearings, where it has a Harlem Globetrotters-like win-loss record, than to further than to try to prove its case before a federal judge where the playing field is more level. In reaction several Republican members of Congress, including Rep. Jeb Hensarling of Texas, chairman of the House Financial Services Committee, introduced legislation in 2015 that would allow for


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Mary Jo White and President Barack Obama at the White House on Jan. 24, 2013, the day Obama nominated White as SEC chair.

removal of administrative cases to federal court. While those efforts likely were doomed to fail in the Obama administration, the Trump administration and the Republican-controlled Congress are more likely to restore these key procedural rights.

SEC 'Stop and Frisk'

In addition to simplifying or eliminating the costly regulatory morass Dodd-Frank created, the Trump administration is likely to effect immediate changes by changing the SEC's "tone at the top." That tone is best captured by White's marching orders to the SEC Enforcement Division to pursue a "broken windows" approach within the securities industry. In a 2013 speech, White fondly recalled that when she was the U.S. Attorney for the Southern District of New York in the 1990s, then-Mayor Rudy Giuliani embraced the "broken windows" concept for New York City policing, cracking down on minor violations such as public urination, "squeegee men," and panhandling in the hope that such efforts would help reduce more serious crimes.

White emphasized her belief that "it is important to pursue even the smallest infractions ... [and] all types of wrongdoing." Indeed, the Enforcement Division began to implement the equivalent of a securities industry "stop and frisk" effort. Whether or not the "broken windows" policy had its intended effect may never be known, but for an agency that routinely tells Congress it has insufficient resources to pursue its regulatory mission, a fair question is: Which more serious violations did the SEC not pursue as a result of cracking down on the securities industry equivalent of "squeegee men"? And, how much unnecessary cost and burden were imposed on honest companies and securities professionals by over-zealous SEC enforcement staff?

Victimless Violations

With the "broken windows" mandate from above, the Enforcement Division has brought all manner of "victimless violations."

For example, the SEC brought a number of enforcement actions in the name of protecting whistleblowers from retaliation when there were no alleged whistleblowers and the SEC alleged no retaliation. In one such case in August, the SEC sued a company for language in its employee severance agreements in which employees' waived any right to monetary recoveries from legal proceedings brought based on communications from the employee to government agencies. The SEC sued the company despite acknowledging that it found no evidence of any instances in which any potential whistleblowers were chilled from contacting the SEC because of this language, and despite the fact that the SEC found no evidence that the company took any actions to enforce these provisions or otherwise prevent employee communications with the SEC.

Similarly, in June, the SEC brought an action against a broker- dealer for failing to comply with anti-money laundering "suspicious activity report" filing requirements when no money laundering took place. The SEC alleged that the broker was aware or should have been aware that certain of its customers were conducting heavy trading in low-priced securities in large volumes. The SEC did not allege that any of the purportedly "suspicious" transactions violated any laws, anti-money laundering or otherwise. In its press release announcing the case, the SEC noted, "[w]hile the SEC has charged other firms with anti-money laundering failures under the federal securities laws, this is the first case against a firm solely for failing to file SARs when appropriate."

In September, the SEC sued an auditing firm — not because of any auditing failure, but rather because of purported personal relationships between members of the audit team and the audit client's personnel. In announcing the $9.3 million penalty, the SEC touted the fact that these were "the first SEC enforcement actions for auditor independence failures due to close personal relationships between auditors and client personnel."

Finally, in March, the SEC sued a public company for its deficient evaluation of internal controls over financial reporting where no financial reporting misstatements took place. The company had experienced rapid growth with which its accounting personnel were unable to keep pace. As a result, the company was unable to complete its standard monthly close process on time, creating "the potential for error" in its financial reporting. However, the SEC did not allege any actual financial reporting errors.

A Return to Core Enforcement

At the end of its fiscal year in October, the SEC announced banner results from its Enforcement Division: a "new single year high for SEC enforcement actions," including the "most ever" actions involving investment advisers or investment companies and "new highs" for Foreign Corrupt Practices Act-related actions.

A few months earlier, White testified in Congress in support of increasing the SEC's budget, observing that "the SEC is charged with overseeing approximately 27,000 market participants, including nearly 12,000 investment advisers, almost 11,000 mutual funds and exchange-traded funds, over 4,000 broker-dealers, and over 400 transfer agents ... 18 national securities exchanges, 10 credit rating agencies ... [and] selectively reviewing the disclosures and financial statements of over 9,100 reporting companies."

Clearly, the SEC Enforcement Division has a lot on its plate and scarce resources to address all the issues that confront it. The debate about where and how to deploy those scarce resources will continue during and after the Trump administration.

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