INSIGHTS FROM

2019 SEC SPEAKS ANNUAL CONFERENCE

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Summary of Information from the 2019 SEC Speaks Annual Conference

The SEC Speaks conference held in Washington, D.C., on April 8-9, 2019 offered perspectives from the current Securities and Exchange Commission Chairman, Commissioners, Division Directors, and Staff about the current initiatives and direction of the SEC for the coming year.

Both public companies trading on public stock exchanges and private companies involved in mergers or acquisitions will benefit from the insight obtained from the regulatory body responsible for regulating the issuance, purchase and sale of their ownership interests.

All SEC leaders at the meeting were consistently focused on the following topics:

- The effect of Brexit on the U.S. capital markets, including risk disclosure obligations related thereto
- Making U.S. public markets and capital cheaper and more accessible to companies, such as by creating new capital formation rules, scaling required disclosures for smaller reporting companies, and creating new private placement exemptions
- The role of digital assets like Bitcoin and other cryptocurrency and whether they are investment contracts and thus securities subject to regulation under the Supreme Court's *Howey* test
- Prioritizing the introduction of the long-awaited Regulation Best Interest, which would hold broker-dealers to the same fiduciary standard as investment advisors: to act in the best interest of their retail investment customers ahead of their own interests
- The Supreme Court's recent decision in *Lorenzo v. SEC* and its holding that disseminating a false statement that a defendant does not "make" under the Court's *Janus* decision can still lead to securities fraud liability under Rule 10b-5(a) and (c)

The following report contains highlights from the remarks of the SEC Chairman Jay Clayton and SEC Commissioners Robert Jackson, Hester Peirce and Elad Roisman, as well remarks from the leaders of various SEC offices and divisions. The views expressed by the SEC personnel during the conference were their own and do not necessarily reflect the views of the SEC.

Chairman Clayton Emphasizes Protecting Investors with Transparent Disclosures from the SEC and the Firms and Financial Professionals it Regulates

Chairman Clayton reaffirmed the SEC's mission to protect investors, ensure fair and efficient markets and facilitate capital formation. Chairman Clayton listed five factors that affect the SEC's mission:

1. Its ability to attract and retain quality staff
2. Investing in technology to oversee increasingly complex markets
3. The need to divert resources to changes in the markets
4. Assessing the effect of Brexit and other events beyond the SEC's control which affect U.S. investors
5. The ability to assess and react to risk

Chairman Clayton also touted the following accomplishments of the SEC this year:

- The SEC's recent U.S. Supreme Court victory in *Lorenzo v. SEC*, wherein the Court ruled that, in SEC enforcement cases, false statements that do not lead to liability under Rule 10b-5(b) because a defendant may have not "made" the statement, can still fall within the scope of "scheme" liability under Rule 10b-5(a) and (c) if the defendant "disseminates" the statement with scienter
- The SEC advanced 23 of 26 proposed rules on its agenda into comment
- The Division of Corporate Finance took actions to encourage capital formation and drive a trend back to registered markets, where he thinks investors are offered greater protection
- The SEC sought comments on more disclosure rules for ETF and open-ended mutual funds given the increased ownership of these investment vehicles by investors
- The SEC is prioritizing finalization of its Best Interest regulation, which the Chairman described as a "top priority for me"
- The SEC brought enforcement actions relating to digital assets like Bitcoin and other cryptocurrency
- The SEC obtained settlements from mutual funds for putting investors in higher-cost funds when the same funds or options were available for a lower cost
- Returning $794 million to investors harmed by misconduct

Chairman Clayton identified three key areas for SEC enforcement this year:

1. Compliance and risk assessment in critical markets and infrastructure
2. Regulation of digital assets like Bitcoin and other cryptocurrencies
3. Focus on cybersecurity

Chairman Clayton was proud of the investor town hall meetings he and other SEC leaders have conducted outside of Washington, which he said provided "valuable information."

Division of Enforcement Panel

Enforcement co-directors Stephanie Avakian and Steven Peikin moderated an interesting and insightful panel discussion of how the SEC handles litigation and the Wells process, among other things.

Lorenzo v. SEC

The Division was happy with the Supreme Court's decision in *Lorenzo v. SEC*, which held, in the context of an SEC administrative enforcement proceeding, that disseminating a false statement that a defendant does not "make" under the Court's *Janus* decision can still lead to securities fraud liability under Rule 10b-5(a) and (c) if the defendant "disseminates" the statement with scienter. The Division outlined three things about the *Lorenzo* decision that if found significant:

- The Court's recognition that the same conduct can violate more than one sub-section of Rule 10b-5
- That misstatements can violate Rule 10b-5(a) and (c), not just Rule 10b-5(b), to which the Court's *Janus* decision applies
- Disseminating a false statement with scienter to defraud is covered by Rule 10b-5(a) and (c) even if the defendant is not a "maker" of the statement under *Janus*

The Division anticipates significant motion practice in pending cases based on the *Lorenzo* decision. The Division anticipates that defense lawyers will try to limit the Court's holding to defendants who "disseminate" a false statement. The SEC takes the position that *Lorenzo* is not so limited, and applies to defendants who create, direct the creation of, or disseminate false statements. The dissenting justices in the *Lorenzo* case opined that the Court's holding would render a "dead letter" the Court's *Janus* decision and its requirement that defendant's "make" a false statement in order to be liable under Rule 10b-5.

The SEC "Judicial and Legislative Developments" panel remarked that *Lorenzo* will result in "broader applicability" of Rule 10b-5(a) and (c) claims in SEC actions, but that *Lorenzo* will have "limited applicability to private actions" because of the additional requirements of private plaintiffs to plead and prove the PSLRA requirements of specific misstatements, heightened scienter, loss causation and reliance.

The SEC disagreed with the position of the *Lorenzo* dissent that the Court's opinion rendered *Janus'*s "maker" requirement a "dead letter" because *Janus* will still save an SEC defendant who neither made nor disseminated a false statement. And not every "mail clerk" who sends a fraudulent statement will be liable unless the SEC can show deceptive conduct and scienter.

The Enforcement Division indicates that jury instructions will be very important, and that the SEC will focus on drafting these in ways that give it the most leeway to have as many sub-sections of Rule 10b-5 possible apply to the charged conduct. The SEC's view is that *Lorenzo* will hamper attempts by defense lawyers to "carve out" and limit certain conduct to certain sub-sections of Rule 10b-5. However, the *Lorenzo* Court did say that prior precedent would guide 10b-5 litigation, and that precedent did recognize specific types of claims that satisfy sub-sections (a) and (c) but not (b), and that said conduct needed to be specifically pled under the pertinent sub-division in private actions.

Cooperation

The Division set forth some illuminating examples of what types of cooperation will result in the best credit possible with the SEC:

- Develop good relationships with the Staff and Enforcement lawyers
- Develop an investigation plan and narrow issues with fact presentations to the Staff
- Reformat search terms and custodians during internal investigations that focuses and streamlines the SEC's investigation
- Narrow document requests to "eliminate the noise" and tailor the production to what the SEC is looking into
- Identify witnesses in a timely manner, or identify witnesses the SEC didn't know about
- Be upfront and prompt about identifying issues

The Division indicated it was unlikely it would formalize its Seaboard Report addressing cooperation by companies to make it more like the DOJ's cooperation standards, which are more prescriptive of what conduct will receive what credit. The SEC indicated this gave it more flexibility, but with the trade-off that its cooperation credit could be more inconsistent.

The Division recommends that attorneys review the settlement terms with the SEC's settlement with Gladius Network LLC, which describes the cooperation and self-reporting that resulted in a settlement with no fine and limited undertakings in misconduct related to an unregistered initial coin offering.

The Division said that companies should not be averse to early meetings before the company has all the answers because that dialogue could still prove helpful to the SEC and thus the company. The Division indicated it would not require a privilege waiver by the company as a condition of extending cooperation credit, but that failure to waive the privilege may result in the deduction of cooperation credit. Counsel should work closely with the SEC to carefully balance protecting the privilege versus obtaining cooperation credit to strike the right balance given the facts of the case.

The Division discussed the strategy of companies remediating misconduct early, rather than saving remediation as a "chit" to use during settlement negotiations. The SEC's view is that remediating early may eliminate that obligation in the context of the settlement.

The Division recognized how unpopular companies viewed the SEC's imposition of an independent compliance consultant (ICC). Factors the SEC considers in determining whether to impose an ICC include how much damage was caused by the fraud and how high up in the company the misconduct occurred. The SEC will consider a hybrid of ICC and self-reporting on remedial measures, so that the ICC's role is tailored to the specific misconduct at issue.

As for multi-agency investigations, the SEC indicated it will seek global resolutions and will work with other state or federal agencies to split the penalty among the agencies.

Effective Advocacy in Wells Meetings and Submissions

Recommendations by the Division for lawyers engaging in the Wells process included the following:

- Prioritize and focus on what's most important and what's really in dispute. For example, don't attack every single statute identified in the Wells Notice, don't spend five pages defining the standards for pleading a Section 10(b) claim, etc. Don't take all 40 pages just to take them, or use 10 point, single-spaced typing to maintain a 40-page limit. Brevity is the best policy.
- Be realistic on what role the Wells submission is serving – is it meant to convince the SEC not to bring any charges, or that the SEC should not bring any scienter claims – and craft your submission accordingly.
- Don't tell the Division that the Commission won't support its recommendation, or cite speeches or comments from individual Commissioners to try and make this point. The Division explained it is going to discuss this case and its specific facts with the Commissioners, and Commissioner speeches just aren't relevant to this process.
- Consider specifically telling the Division about specific documents or witness testimony that may not get into evidence and that will prevent them from proving their claims. When a Wells Notice is issued, the SEC has developed an "opening statement" detail of its case, so specifically discussing problems the SEC may have at trial will get their attention. The Division descried as "significantly effective" a presentation that revolved around the jury instructions and how certain documents, evidence issues and testimony elicited on cross examination would prevent the SEC from proving the elements charged in the jury instructions.
- If the SEC wants a pre-Wells statement, it may reach out for a whitepaper on a certain issue before a Wells Notice issues or a Wells meeting is held. Defense lawyers should weigh whether an early submission infers a presumption about liability.
- The SEC said that submitting expert reports with a Wells submission is only persuasive if it is of the type and quality that would be admissible in Court. Reports that are cursory and don't critically examine the facts will not be helpful; the SEC knows you will likely have an expert at trial and won't be discouraged by that fact so don't produce a shoddy report just to make that point; it will only hurt your credibility.
- Be thoughtful about requesting that high-level directors attend Wells meetings rather than staff.

Office of Compliance, Inspections & Examinations (OCIE) Panel

OCIE leaders were candid about the adverse affect the government shutdown had on its oversight operations of investment advisers, lamenting that FINRA didn't have that problem as a private SRO and thus could keep up its examinations of broker dealers during the shutdown.

Areas of focus for OCIE in the coming year include the following:

- Best Interest Regulation is a key priority. OCIE needs to develop "inspectable criteria" to examine broker dealers on this standard and then develop a reasonable sample size of broker dealers to examine.
- Focus on how the EU GDPR (General Data Protection Regulation) and similar data protection laws affect U.S. market participants. It is a challenge for OCIE to determine how U.S. investors and firms fit into the GDPR.
- Brexit is an additional challenge because the U.K. has its own data protection laws and regulations.
- Regulating National Statistical Rating Agencies (NSROs) and eight areas posing the greatest risk.
- Creation of a credit rating subcommittee that will make recommendations to FINSAC (Financial Sector Advisory Center).
- Focus on high-risk areas and newly registered registrants to ensure compliance programs are adequate.
- Capital protection - ensure firms are developing programs to protect investor funds in the event the firm fails.
- Micro-cap securities - focus is on these securities because they tend to hit the retail investor sector harder.
- OCIE has reviewed all Investment Adviser (IA) deficiency letters and developed a top 10 list of IA deficiencies, the top five of which are:
    - Custody
    - Compliance
    - Regulatory filings
    - Code of Ethics
    - Books and records

Division of Trading and Markets Panel

The Best Interest Regulation ("Regulation BI") is a top priority for this Division. It has received over 6,000 comment letters for this rule, which it says has three primary components:

1. Disclosure
2. Duty of care
3. Conflicts

Regulation BI will also enhance broker dealer suitability obligations. Former SEC Chairman Paul Atkins advised the SEC to be very careful about the duties it imposes on broker dealers because of what he dubbed the "feeding frenzy of trial attorneys" that will follow the Rule's implementation.

The Division is also focusing on equity market structuring, including: 1) reviewing fund transaction fees; 2) an Alternative Trading Systems (ATS) disclosure rule; and 3) broker ordering transparency.

Comments of Commissioner Robert Jackson

Commissioner Jackson identified three areas of focus and interest he has over the coming year, with the following viewpoints:

1. Best Interest Standard – The SEC needs to find a way to get this rule done, but it should be a bipartisan effort. This will be a "long litigated" rule in the markets and in the courts in his view, so he feels it's important that the Commission be unified on it.
2. Cybersecurity – He supported the SEC's recent guidance on cybersecurity, but he would go further and require studies of how hackers are attacking and using corporate information.
3. Reduce the cost of taking companies public – Specifically, Commissioner Jackson would like to revisit the 7% spread companies pay when going public. Given advances in technology, this amount should be lower in his view.

Commissioner Jackson also had some interesting comments about how insider-trading case law fits into today's market structure and realities. He is not sure whether the SEC could or should write a rule on insider trading, but he thinks the case law and how it has developed deserves a hard look.

Commenting on robo-advisers, he thinks that while they may lower the cost of access to the capital markets for smaller investors, our society won't "innovate away" the desire of investors to discuss their financial investments face-to-face with a human being.

Comments of Commissioner Hester Peirce

Using an interesting "SEC Secret Garden" theme, Commissioner Peirce opined on the importance of publication of and access to various SEC guidance and interpretations it periodically offers and which are not subject to judicial review or appeal. Some market participants have dubbed these SEC proclamations "secret rules" that only larger participants, with sophisticated lawyers, can access and use. Commissioner Peirce said that the SEC has made strides in making its interpretations more transparent, including a reminder that SEC No-Action letters were previously not published, but now are and are accessible more easily via the internet.

Commissioner Peirce reminded participants that the SEC can only act through its appointed Commissioners, rather than Staff guidance and interpretations. But the Staff guidance and interpretations, like No-Action letters, do provide helpful, tailored guidance to unique issues that may arise in implementing a Rule or securities law based on specific facts. That process also may help refine some "clunky" SEC rules. All of this helps make Staff guidance more transparent and consistent, and permits the full Commission to monitor Staff guidance. The SEC Staff will sometimes withdraw previously issued No-Action letters that become outdated based on current market realities.

Commissioner Peirce said firms should not be reviewed or examined against unpublished No-Action letters, "draft" Staff guidance, or private discussions with Staff or Commissioners. This, Commissioner Peirce opined, "crosses the line" into "secret laws." She indicated that the public needs to be able to assess whether the SEC is abiding by the limits on its legislative authority from Congress.

She confirmed that SEC Staff guidance is informed by public comment and debate, and is reviewable by the public and the SEC Commissioners.

Comments of Commissioner Elad Roisman

Commissioner Roisman's priorities include:

- Guiding more companies to the capital markets
- Market structure issues including equity and fixed income markets
- Protecting seniors and other vulnerable investors
- Improving the proxy process and its attendant SEC rules

In describing the needs to bring more companies to market, Commissioner Roisman said public markets have been described as "being in hell without dying." Litigation and the Supreme Court's *Cyan* decision have made public markets and D&O insurance more expensive. Commissioner Roisman believes that more companies should have easier access to capital markets so investors can participate in a company's success. As a reminder of the importance of opening public markets to the success of companies and their shareholders, Commissioner Roisman remarked that when Apple went public in 1980 some states banned the purchase of Apple stock because it was "too risky."

Commissioner Roisman also thinks the SEC needs to more clearly articulate when the activities of finders will require registration as broker dealers.

Further Information

Please contact Miller Canfield for more detailed information about the SEC Speaks meeting or to discuss any questions about securities issues that you or your company face.

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