



## Statement of the U.S. Chamber of Commerce

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**ON: Ensuring Effectiveness, Fairness, and Transparency  
in Securities Law Enforcement**

**TO: House Committee on Financial Services,  
Subcommittee on Capital Markets, Securities and  
Investment**

**BY: Thomas Quadman, Executive Vice President, Center  
for Capital Markets Competitiveness, U.S. Chamber of  
Commerce**

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1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Chairman Huizenga, Ranking Member Maloney, and members of the Subcommittee on Capital Markets, Securities, and Investment: my name is Tom Quaadman, executive vice president of the Center for Capital Markets Competitiveness (“CCMC”) at the U.S. Chamber of Commerce (“Chamber”).

The Chamber views a strong and fair Securities and Exchange Commission (“SEC”) as a critical and essential element needed for efficient capital markets. Having a strong securities regulator is necessary for investors and businesses to have the certainty needed to transfer capital for its best use with an expectation of return. This allows market participants to engage in reasonable risk taking on a fair playing field. A rigorous enforcement regime ensures efficient markets by rooting out fraudsters and other bad actors, but if not properly calibrated, it will also serve to discourage legitimate businesses that may be seeking growth capital. This is an especially acute issue in light of the declining number of public companies—in the past twenty years, the number of U.S. public companies has been cut in half.

The Chamber has become increasingly focused on ensuring that the SEC remains the premier securities regulator and is well-positioned for the challenges of a twenty-first century economy. As members of this Subcommittee know, capital markets have fundamentally changed since the SEC was created during the Great Depression of the 1930s. Additionally, managerial challenges within the agency have at times created obstacles that have prevented the SEC from acquiring the appropriate expertise and deploying its resources for the best use, undercutting its ability to evolve with changing markets and oversee them. Of particular importance to today’s hearing, changes in enforcement practices have created fundamental issues of due process and fairness that are at the heart of any legal proceeding under our constitutional form of government. Relatedly, it has sometimes been difficult for the SEC to focus on all of the elements of its tripartite mission—promoting investor protection, facilitating capital formation, and maintaining fair, orderly, and efficient markets. We believe SEC Chairman Jay Clayton is aware of these issues and we commend him for his efforts to overcome them.

Over the years, the Chamber has identified shortcomings in our financial regulatory structure that make it harder for businesses to acquire the capital needed to grow and prosper. As far back as 2007, the Chamber released a report, the [\*Report and Recommendations of the Commission on the Regulation of U.S. Capital Markets in the 21st Century\*](#), and a report in 2011, the [\*U.S. Capital Markets Competitiveness, the Unfinished Agenda\*](#), to identify problems and the shortfalls of our financial regulatory system and the difficulty this puts on the United States to compete in a global economy.

The Chamber has also offered solutions. For example, in 2009, we issued a report, [Examining the Efficiency and Effectiveness of the U.S. Securities and Exchange Commission](#), and in 2011, the [U.S. Securities and Exchange Commission: a Roadmap for Transformational Reform](#), that contained 51 recommendations for managerial reforms and regulatory enhancements to help the SEC acquire the knowledge and expertise needed to better understand and oversee the markets and products it regulates.

Of particular relevance to today's hearing, in July 2015 the Chamber issued a report, [Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices](#) ("Chamber SEC enforcement report"), which made 28 specific recommendations to improve SEC enforcement and due process.

The Chamber's 2015 SEC enforcement report reviewed the practices of the SEC Enforcement Division, changes in strategy and practice by the SEC, the evolving use of administrative proceedings, and the adequacy of rules of practice. This paper was the culmination of almost two years of effort that included a survey of more than 75 companies to identify areas where there was a perceived ambiguity or lack of clarity in the process. We conducted extensive interviews with a wide range of more than 30 former SEC officials, legal experts, and corporate counsels to develop specific recommendations. We included the ideas that have broad support from those who generously participated in this process.

The Chamber's 2015 enforcement report recommended a wide variety of structural and procedural changes to the SEC's enforcement process. At a high level, our recommendations focused on:

- Providing a structure for the choice of forum decision that incorporates due process protection;
- Strengthening the "Wells Process" so that defendants in SEC investigations have a more robust ability to marshal a defense before the SEC commences litigation;
- Clarifying the SEC policy on admissions of liability in settled cases;
- Reducing duplication in regulatory enforcement;
- Rationalizing the "broken windows" enforcement policy and the need for alternative methods of resolving matters;
- Improving oversight by the SEC commissioners over the SEC enforcement staff; and
- Streamlining and improving the efficiency of the SEC investigation process, including with respect to document requests, production, and preservation.

To describe a few of these recommendations in greater detail, oversight of the SEC Enforcement program by the five presidentially-appointed commissioners remains an area that we believe is critical. Macro-level Commission oversight of the overall enforcement program, in terms of priorities and areas of emphasis, allocation of resources, and periodic assessment of effectiveness has traditionally been extremely limited. Given the importance of the SEC's enforcement program, a macro-level oversight process is required. First, there must be systematic collection of quantitative and qualitative information on the program operations. Second, there must be a regular periodic process for presenting this information to the Commission in a manner that provides them with a meaningful, not a pro forma, opportunity to provide input and direction.

To this end, we recommended that the Division of Enforcement should submit a quarterly management report to the five commissioners containing productivity and efficiency metrics developed by the agency's Division of Economic and Risk Analysis. The commissioners should receive quarterly oversight briefings on the enforcement program, with an emphasis on "national priority" investigations, investigations raising novel or complex legal questions, oldest active investigations, post-mortem analysis of litigated cases decided not in favor of the SEC, and new or emerging areas warranting investigation. We also recommended that the SEC improve transparency of its enforcement regime to place the public and regulated entities on notice as to emerging regulatory issues and enforcement priorities. For example, we recommended that the SEC should publish annually a report on its enforcement program, provide a public comment period on relevant issues, and conduct an annual public roundtable to discuss the report and the operations of its enforcement program.

We also offered several recommendations in the 2015 report to improve the efficiency and effectiveness of the SEC investigation process. The agency's investigation process is the largest program at the SEC. It is also the most opaque. The Commission provides very limited information on the process, except when a formal enforcement action is filed. The process is often long and costly, both to the SEC and to persons and entities that are the subjects of the investigation. Because the great majority of SEC investigations are closed without any action taken, these substantial costs are incurred by significant numbers of persons and entities that are never charged with committing violations. For public companies that are unable to raise capital because of the uncertainties associated with an open SEC investigation or that suffer large share-price decreases upon the announcement of an investigation, the consequences can be significant. By improving the efficiency of the investigation process, the SEC would make more effective use of its limited resources and, at the same time, reduce the substantial costs incurred by persons and entities that are subjected to the process. There, our recommendations focused on the importance of

better internal management of the process and on ways to streamline the document production process.

In the 2015 report, we also advocated for improving the efficiency of the investigative process. Improving management of the investigative process requires greater internal controls over the duration of investigations, the metrics that are used to evaluate and incentivize the staff, the problems resulting from staff turnover, and the case closing process. Additionally, the report recommended a review and changes in the rules of practice to make due process enhancements, creating a right of removal to district court under appropriate circumstances and strengthening the Wells process by which defendants mount a defense to the staff and commissioners before the commissioners vote to commence litigation.

Reducing duplication in regulatory enforcement was another theme of the Chamber's 2015 enforcement report. As we noted in the report, regulation of the financial markets in the United States has historically involved multiple entities, including multiple agencies at the federal level (the SEC, U.S. Commodity Futures Trading Commission, and the Department of Justice), multiple self-regulatory organizations (SRO), and at the state level, a state securities regulator and a state attorney general. For businesses engaged across the financial sector, prudential supervision can mean multiple examinations by more than one SEC regional office in addition to a designated SRO, and the multiple federal banking regulators. Globalization of the securities markets has added one more layer of foreign regulation for multinational companies.

When companies respond to allegations of improper activities, management's focus is necessarily diverted from the day-to-day running of its business. That is a consequence of doing business in a regulated society. But, we believe there should be some understanding on government's part that, in the current era, firms are frequently subject to multiple domestic and foreign regulators. Responding to multiple regulators with respect to the same conduct or transaction is not, and should not be allowed to become, a regular attribute of doing business. It is counterproductive—and damaging to shareholders—to subject firms and individuals serially to multiple SEC inquiries or multiple regulators and self-regulators for the same alleged misconduct.

Regulatory duplication occurs on three different levels—duplicative or overlapping investigations and exams by different offices of the SEC; duplicative or overlapping efforts within the United States at the federal and state levels; and most recently, duplicative or overlapping efforts internationally. Of course, there is a limit to what the SEC can accomplish with regard to duplication at the federal level, the federal and state levels, or the international level, given the sovereignty or

independence of other enforcement authorities that can pursue the same (or similar) conduct that the SEC can pursue. There are limits to the agency's ability to cabin all duplicative proceedings.

However, in preparing the 2015 report, it became clear the scope of the problem appears to be increasing. For example, during the preparation of our 2015 enforcement report, we learned from multiple interviewees of firms that were regulated by the SEC, FINRA, the Office of the Comptroller of the Currency, the Federal Reserve Board, and the Consumer Financial Protection Bureau, that they frequently experienced upward of 60 regulatory examinations each year. We have also observed a growing trend of state enforcement agencies bringing state charges that are substantially the same as those brought against the same defendant by their federal enforcement counterparts.

To remedy this situation, the 2015 report recommended the SEC take steps to eliminate duplicative and overlapping enforcement responses within the Commission and by multiple enforcement authorities against the same individuals or entities for effectively the same misconduct. In this respect, we believe the SEC should take a leadership role among regulatory bodies at the federal, state, and international levels to reduce or eliminate duplicative and overlapping investigations and enforcement actions for the same conduct.

To this end, the 2015 Chamber enforcement report recommends that, within the United States, the SEC should:

- Consider greater use of memoranda of understanding with one or more other enforcement authorities to avoid “duplication of efforts, unnecessary burdens on businesses, and ensuring consistent enforcement” of securities-related requirements;
- Seek to proceed jointly with other enforcement authorities at the early stages of an investigation;
- Coordinate non-cause examinations with other regulatory agencies and self-regulatory organizations;
- Before commencing an enforcement action, contact other agencies to try to file a single action reflecting the common interest of multiple regulators;
- Consider standing down, or utilizing a deferred prosecution agreement, where effective action already has been taken (or commenced) by another enforcement authority;

- Develop mutual coordination agreements with domestic enforcement authorities, and jointly pledge to eliminate, where appropriate, duplicative enforcement actions; and
- Pursue special efforts to eliminate or diminish the extensive duplication of efforts that occurs on the part of state and local enforcement authorities.

As we noted in the 2015 report, it would be a mistake to misinterpret any of these recommendations as calling for changes that would either weaken enforcement or erect any process barriers that would impede vigorous action by the SEC. This 2015 report proposed changes that would both further maintain a tough-as-nails efforts to punish and deter fraud while ensuring that honest market participants benefit from a clear and predictable process. The Chamber firmly believes that investors, market participants, and the SEC all benefit from this approach.

We are encouraged that the SEC has been moving forward on some of the Chamber’s recommendations. The SEC continues to integrate trial lawyers into the investigative process at an early stage. Similarly, the SEC has also adopted incremental changes to its rules of practice for administrative proceedings. This responds to a specific recommendation in our 2015 report. And the SEC appears to have begun focusing on programmatically more important cases in lieu of pursuing so-called “broken windows,” a strategy that has previously strained agency resources and sent a mixed message to the markets.

To his credit, Chairman Clayton has also begun to put his own mark on enforcement priorities at the SEC. We applaud his efforts to focus on “Mr. and Mrs. 401(k)” by launching a Retail Strategy Task Force. As Chairman Clayton has noted, retail investors are more vulnerable to fraud schemes than institutional or other sophisticated investors. And we commend the agency’s efforts to focus on cybersecurity. Indeed, the Enforcement Division’s new Cyber Unit has already taken important strides to combat cyber-fraud in our capital markets.

Our discussion regarding relevant legislation being considered at today’s hearing is discussed in further detail below.

## **H.R. 5037, the Securities Fraud Act of 2018**

As noted above, reducing duplicative enforcement was a major theme of the Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices. Responding to multiple regulators with respect to the same conduct or transaction is not, and should not be allowed to become, a regular attribute of doing business. It is counterproductive—and

damaging to shareholders—to subject firms and individuals serially to multiple SEC inquiries, self-regulatory organizations, or multiple state regulators or attorneys general, for the same alleged misconduct.

But a more pernicious problem exists within the scope of securities enforcement, and that is state authorities acting as *de facto* national regulators for companies who list their shares on a national securities exchange. It is worth remembering that the SEC itself was created to establish a system of *national* securities regulation and enforcement for entities engaged in interstate commerce. States should not be able to substitute their powers for those that are rightfully reserved for a federal regulator. State attorneys general in particular certainly have a right to protect their residents from all types of criminal conduct, frauds, and scams – but that does not mean that a single state elected official should be allowed to impact all aspects of a national economy.

Emblematic of this problem is New York State’s Martin Act, a law enacted in 1921 to facilitate the prosecution of “bucket shops” and other scams directed at small investors. For 80 years, the law was used responsibly by New York attorneys general to protect residents from stock scams or other frauds.

However, in the last decade, the Martin Act was weaponized by New York attorneys general. This was largely due to the fact that the Martin Act does not require the attorney general to prove fraudulent intent, and does not even require prosecutors to show that anyone has been injured or that any securities transaction actually took place.

Because New York is home to thousands of U.S.-listed public companies, the Martin Act effectively anoints the state attorney general a national regulator for these businesses engaged in interstate commerce. In the Constitution, the Federal Government has sole domain over issues involved in interstate commerce. The Martin Act harms certainty by allowing one state to set policies that compete with the SEC.

Introduction of the Securities Fraud Act of 2018 is an important step towards rebalancing securities enforcement as it relates to nationally listed public companies. The legislation clarifies and reaffirms federal law’s supremacy and Congress’s authority over interstate commerce (including our national securities markets). It limits the authority of state officials to establish national regulations, while ensuring that they can continue to protect the residents of their state. This bill would preserve the ability of the New York Attorney General to bring cases under the Martin Act. However, civil cases would be required to be heard in federal court and the intent to

defraud proved. These requirements are wholly consistent with the history of the federal securities laws, and would also help prosecutors prioritize important enforcement cases against bad actors. We believe that efforts in this area should not harm the ability of state securities administrators to prosecute crimes such as boiler rooms or pump and dump schemes.

The Chamber appreciates Rep. MacArthur’s work on this important legislation, and we look forward to working with all members of the Financial Services Committee as it advances through the legislative process.

### **H.R. 2128, the Due Process Restoration Act of 2017**

The Chamber supports the Due Process Restoration Act of 2017, with a suggested amendment described in more detail below. This legislation would provide respondents in SEC administrative proceedings the right to have their case removed to federal district court if the SEC is seeking both a cease and desist order and a monetary penalty.

As noted above, a major concern identified during the development of the Examining U.S. Securities and Exchange Commission Enforcement: Recommendations on Current Processes and Practices was the increased and widespread use of administrative proceedings for enforcement cases. Since enactment of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act – which expanded the SEC’s authority to use administrative proceedings – we began to see such proceedings used as the primary means of the SEC prosecuting enforcement cases under its non-criminal powers. This has created an imbalance within the system that endangers the rights of defendants and undermines the use of appropriate enforcement tools, while raising important questions regarding the separation of powers between the executive and judicial branches of government.

In 2016, the SEC adopted a series of amendments to its rules of practice that were intended to address many of the concerns raised over the agency’s increased use of administrative forums.<sup>1</sup> While these amendments were a small step in the right direction, the protections afforded defendants in administrative proceedings still fall well short of those provided in an Article III court, and the due process standards provided by the Federal Rules of Evidence and the Federal Rules of Civil Procedure.<sup>2</sup> For example, the number of depositions allowed to be taken by respondents in

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<sup>1</sup> <https://www.sec.gov/rules/final/2016/34-78319.pdf>

<sup>2</sup> See e.g. U.S. Chamber comment letter on proposed amendments to rules of practice, available at: <https://www.sec.gov/comments/s7-18-15/s71815-12.pdf>

administrative proceedings and the amount of time respondents has to build a defense still pale in comparison to what is provided for in federal district court.

We believe that the Due Process Restoration Act of 2015 is an important step forward in restoring the balance between the appropriate uses of administrative proceedings and preserving the due process rights of defendants. This bill, if passed, would allow defendants, within parameters, to have the option to take a case to district court. We believe this bill would allow for the SEC to use administrative proceedings as they have been used historically, while allowing defendants all available options. If the SEC rules of practice are amended to allow for a fair process of discovery, administrative proceedings would be a fair and level playing field. The right of removal would not, in our opinion, burden court dockets.

Nevertheless there is one amendment we would suggest making to H.R. 2128 as it moves through the legislative process. The legislation changes the burden of proof that the SEC must use in an administrative proceeding to a “clear and convincing” standard. We believe the burden of proof should be the same in an administrative proceeding or a district court case. While we understand the thought behind the use of a clear and convincing standard, this can have unforeseen consequences that may not help defendants or appropriate enforcement activities.

The Chamber believes that the passage of the Due Process Restoration Act of 2017, with our suggested amendment, as well as further changes to the SEC’s rules of practice, would allow for both fair due process and strong enforcement policies.

We ask that the Subcommittee and House consider both of these bills expeditiously in order to provide American businesses with greater enforcement certainty that encourages them to compete, thrive, and create jobs.

I am happy to take any questions that you may have at this time.