

March 5, 2021

## Financial Services Update

### Gensler's Hearing Testimony Sheds Light on SEC Priorities

On March 2, Gary Gensler, picked to head the Securities and Exchange Commission (SEC), appeared before the Senate Banking Committee for a [joint nomination hearing](#) along with Rohit Chopra, the Consumer Financial Protection Bureau Director nominee.

Gensler faced questions about investor protection, corporate disclosures including on climate risk and diversity, as well as the fallout from the GameStop trading frenzy and what kind of regulatory response he may seek in addition to the study of the incident the SEC has already launched. In response to a question from Senator Thom Tillis (R-NC) about the potential negative impact of a financial transaction tax, Gensler noted the U.S. has a very modest transaction fee to support the SEC budget of what is currently about \$1.8 billion, and he said that there has not been a negative outcome at the current level.

Gensler told the Banking Committee that he will work to ensure “transparency and accountability in our markets, so people can invest with confidence, and be protected from fraud and manipulation” and promote “efficiency and competition, so our markets operate with lower costs to companies and higher returns to investors.” He emphasized he will focus on making sure “our markets serve the needs of working families.” He also focused on financial technology being the “force for good” and emphasized the “market and technology are always changing, and our rules have to change” along with them.

The following key issues highlight potential SEC priorities under Gensler:

#### Market Structure

##### **Payment for Order Flow**

- Gensler said technologies and markets change and stated recent events have raised the need to evaluate market structure, including payment for order flow and whether investors are getting best execution.
- Gensler noted that the SEC will look at market structure and the equities market around payment for order flow – he raised questions about concentration of the retail order flow and its impact on the pricing of capital and best execution in this context.

##### **Shortening the Settlement Cycle**

- In response to a question by Senator Patrick Toomey (R-PA), Gensler stated that he will consider some of the recommendations included in a [recent letter](#) by lawmakers to the SEC acting chair, particularly shortening the settlement cycle.

- Toomey stated that he hopes Gensler considers a faster settlement cycle on equities. Others have also called for the shortening of the settlement cycle. Recently, the Depository Trust & Clearing Corporation released a [white paper](#) that outlines a two-year industry roadmap for shortening the settlement cycle for U.S. equities to one business day after the trade is executed (T+1).

### **Volatility in Trading**

- Gensler noted the following questions are on his mind when evaluating volatility in trading:
  1. How to ensure that customers still get best execution in the face of payment for order flow
  2. How to protect investors using trading applications with behavioral prompts designed to incentivize customers to trade more
  3. How to ensure customers' access to markets when trading apps at times fall short of needed matching funds
  4. How to promote competition in markets when a few firms have come to dominate those markets
  5. How to update back office infrastructure to lower risk and cost

### **SEC Rule Review**

#### **Proxy Voting Advice Rule**

- Gensler stated he would want to understand SEC's prior rules better, including the proxy advisory rule.
- In particular, Gensler noted he will review whether the proxy rule has addressed potential conflicts of interest in the least amount of cost.
- He noted it is efficient for pension funds to have proxy advisors.

### **Environmental, Social and Corporate Governance**

#### **Disclosure Requirements**

- Gensler noted he is committed to basing disclosure requirements on materiality and emphasized that materiality is about the significance to the "mix of information to a reasonable investor" citing the Supreme Court. He said he will be grounded in what courts have ruled, the law, the economic analysis about materiality, and what reasonable investors are seeking.
- *Political spending and materiality:* Gensler's comments hinted that he may find political disclosures to be material and said, if confirmed, he believed the Commission should consider the materiality of political spending in light of "strong investor interest." Gensler stated last year's proxy season of about 80 shareholder proposals and the 1.2 million comments submitted to the SEC last year supporting political spending disclosure indicate support for such disclosures. Senator Bob Menendez (D-NJ) also stated he will reintroduce the [Shareholder Protection Act](#) to require companies to disclose their political expenditures. Senator Menendez [reintroduced this legislation](#) on March 2, 2021.
- *Climate Disclosure:* Gensler agreed with Senator Elizabeth Warren (D-MA) that companies should not hide their climate risks from their investors.
- *Private Equity:* Gensler stated that it is at the heart of the [Investment Advisers Act](#) that companies share their fees, any conflicts, and a description of their business model with their investors.

## Diversity

- *SEC review of Board Diversity Rule*: Gensler stated, if confirmed, he will review all comments on the [NASDAQ listed companies rule](#), and indicated that he believes diversity in boards and senior leadership benefits decision making.
- Gensler stated he will look at what information investors want in regard to human capital, including diversity. Gensler's comments hint that the SEC may review the agency's 2019 Diversity Disclosure Rule under his leadership.

## Competition, Systemic Risk, and Investor Protection

### NRSROs

- In response to questions about the Federal Reserve 13(3) emergency facilities not recognizing smaller nationally recognized statistical rating organizations (NRSROs), Gensler agreed that promoting open competition among NRSROs is important to protect investors and promote vibrant capital markets—he stated that he looks forward to working with Congress to promote and support competition in the credit rating space.

### Financial Stability Oversight Council

- Gensler said, if confirmed, he looks forward to working with members of the FSOC on designations if they are appropriate and if there are activities that could be systemic.
- Gensler stated he will submit an answer for the record on the question of whether he believes the SEC has the necessary mandate and tools to pursue an activities-based approach of systemic risk evaluation.

### Arbitration Clause

- Gensler stated that while arbitration has its place, it is also important that investors have an avenue to redress their claims in the courts.

## Digital Assets and Blockchain Technology

- Gensler noted that Bitcoin and other cryptocurrencies have brought new thinking to payments and financial inclusion, but they have also “raised new issues of investor protection that we still need to attend to” and stated that, if confirmed, he would work with fellow commissioners to both promote the new innovation but also, at the core, ensure investor protection. He noted areas of consumer protection include the custody of customer funds and preventing fraud and manipulation.
- Gensler emphasized the need for the SEC to be technology neutral and stated that if there are cryptocurrencies that fall under the SEC's jurisdiction—to the extent that there is an offering of investor contract or security under the SEC's remit—he will ensure that there is appropriate investor protection. However, he noted that *if* the digital asset is a commodity, “as bitcoin has been deemed to be,” then it is “either a question for Congress” as to how it should be overseen or “possibly a question for the Commodity Futures Trading Commission.”
- Gensler stated that as technology evolves it is important for the SEC to provide clarity, whether through guidance or no-action letters.

- Gensler recognized the potential benefits of blockchain technology including in inclusive payment structures providing faster and lower cost, as well as trade finance and medical records technology.

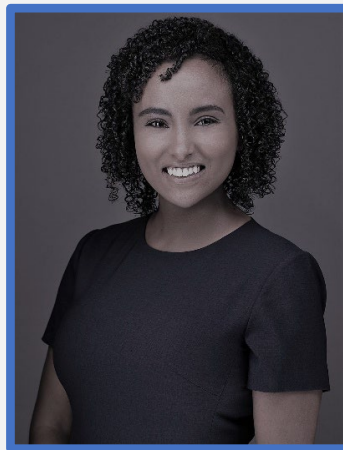
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