The Daily Dish

The Stealthy SEC in Action

DOUGLAS HOLTZ-EAKIN | SEPTEMBER 27, 2023

The Biden Administration has matured from a red-tape child prodigy to a full-grown bureaucratic behemoth that has thus far saddled the economy with over $420 billion in new regulatory burden costs. It is quite the collection of economic meddlers, but among them the Securities and Exchange Commission (SEC) stands out. It has achieved the trifecta of ignoring costs, overstepping its authorities, and regulating where no problem demands it.

These actions are nicely documented by Thomas Kingsley in a new American Action Forum paper. Under Chair Gensler the SEC has issued a near-unprecedented number of rulemakings – nearly double that of his predecessors at the same point in their tenures. It has sought to remake every section of the financial services sector, from private markets to the stock market, to environmental disclosure rules, and beyond.

Some of the lowlights include the treatment of shareholder proposals, the regulation of private funds, climate disclosures, and stock-trading rules. With a new staff legal bulletin and a reversal of previous guidance, the SEC instituted a shareholder proposal process that will significantly increase the number of questions that can be brought by shareholders at an annual meeting. Moreover, as Kingsley notes, those questions can include “topics only tangentially aligned with the company’s business model, over decisions that might be immaterial to a company’s bottom line (and, one might think, to the performance of a shareholder’s stock).”

Regarding private funds, Gensler intended to fundamentally restructure the $27 trillion private market. As proposed, “the rule required registered private funds to distribute quarterly financial statements and an annual audit requirement. These financial statements would include information on fees charged, and the SEC will require that certain fees be ‘fair and equitable.’ The rule also adds new restrictions on certain activities, including fund borrowing arrangements.”

What is even more galling is that it is not obvious the SEC actually has the authority to regulate private markets, especially a rule that could cost nearly $1 billion. A final version of the rule was much milder than the original but is the subject of a lawsuit led by the Managed Funds Association, the American Investment Council, and the National Association of Private Fund Managers.

Perhaps the most prominent SEC folly has been the rule to require disclosure of public companies’ climate-change risks. Per Kingsley: “in March 2022 the SEC released a?proposed rule?that would, for the first time, require public companies operating in the United States to provide climate-related information in both their registration statements and annual reporting. These disclosures would require businesses to provide information on the climate-related risks they face, their governance and risk management processes in place to mitigate those risks, and their greenhouse gas (GHG) emissions.?These disclosures would cover not just the financial risks stemming from climate (itself notoriously difficult to model) but would extend to both a company’s GHG emissions and its climate-related strategy and risk processes.”

The proposal had two extreme challenges. The first was the need to assess GHG emissions in the entire supply chain, while the second is the reliance on the accounting concept of materiality. In short, the businesses would have to decide what was material – which means it would not be comparable across businesses – and somehow measure it across all the firms and products in the supply chain. The rule was daunting in its policy overreach, complexity, and potential disruption of capital markets.

Finally, in the aftermath of the GameStop trading frenzy, the SEC proposed a rule that would artificially constrain high-volume, high-speed brokerages. “Under the SEC’s proposal, small-broker stock orders would be sent to auctions, enabling a wide variety of actors (from high-speed traders to traditional investors) to ‘compete’ to fulfill stock orders. The SEC’s proposal would also seek to circumvent ‘payment for order flow’ practices by requiring brokers to ensure that their customers get the best possible deal on the market.”