

**MEMO# 19399**

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## **FINANCIAL SERVICES ROUNDTABLE PAPER REGARDING SEC RULEMAKING**

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19399] November 22, 2005 TO: BOARD OF GOVERNORS No. 57-05 RE: FINANCIAL SERVICES ROUNDTABLE PAPER REGARDING SEC RULEMAKING The Financial Services Roundtable recently sponsored a paper analyzing the Securities and Exchange Commission's consideration of the effect of its rulemaking on efficiency, competition and capital formation.\* According to the paper, the SEC did not appropriately account for the effect of its rulemaking on efficiency, competition and capital formation in several instances, and it recommends that the SEC consider taking certain regulatory action to promote these principles. The most significant aspects of the paper are summarized below.

**Regulation of Mutual Funds** The paper criticizes the SEC's recent rule to require that the chairman of a mutual fund board and 75 percent of its directors be independent of the fund's investment adviser. It states that this is an example of the SEC focusing only on investor protection and not on providing investors with an efficient and competitive mutual fund industry that will enhance capital formation. The paper suggests that the SEC consider withdrawal of, or substantial revisions to, the rule.

**Role of the SEC as the Primary Regulator of Securities** The paper states that Congress has explicitly pre-empted state regulation of the securities markets in some areas, and where it has not done so, the SEC should consider asserting itself as the sole regulator of the securities markets. The paper states that by so doing, the SEC would be acting in the interests of assuring efficiency, competition, and the promotion of capital formation.

**Policymaking Through Enforcement Proceedings** The paper states that the SEC has increasingly imposed requirements on regulated entities through undertakings in the settlement of enforcement actions. It further states that in some cases, these settlement cases have — or acquire — the force of rules, applicable as “best \* See Peter J. Wallison and Cameron D. Smith, *The Responsibility of the Securities and Exchange Commission for Efficiency, Competition and Capital Formation: Reforms for the First 1000 Days*, (October 6, 2005). 2 practices” to an entire industry, negating the protections and benefits of the Administrative Procedure Act. The paper also states that the SEC staff has adopted positions on significant policy issues, even though the policy has not been published for comment or formally approved by the SEC. The paper recommends that the SEC make clear that any significant policies that are applied on an industry-wide basis must be vetted through the APA process.

**Reforming Enforcement** The paper recommends that the SEC consider several procedural reforms to its enforcement process including: additional procedures to advise companies under SEC investigation that the investigation has been closed; placing limits on the scope and number of information requests to individual companies and industry wide “sweeps”; and considering making the SEC's Office of Compliance and Inspections part of the SEC's

operating divisions. Promoting a Global Capital Market The paper recommends that the SEC reconsider requiring foreign companies to use U.S. generally accepted accounting principles for financial disclosure. The paper also recommends that the SEC consider permitting foreign securities exchanges and foreign brokers to accept unsolicited orders from U.S. investors without registering with the SEC as an exchange. The paper states that by doing so the SEC would be encouraging the development of a robust international securities market. Internal Controls The paper criticizes the SEC for requiring companies to establish internal controls that provide for the safeguarding of assets. It states that this requirement is expensive for companies to implement and goes beyond the mandate of the Sarbanes-Oxley Act of 2002, which requires companies to establish internal controls only for the purpose of financial reporting. The paper recommends that the SEC eliminate this requirement. SEC Regulation NMS The paper discusses SEC Regulation NMS, which, among other things, extended the essential elements of a trade-through rule to all market centers. The paper states that the SEC did so on the rationale that a trade-through rule was necessary to encourage limit orders and on very weak evidence that it would protect investors. The paper recommends that before Regulation NMS goes into effect, that the SEC institute a pilot program to test whether a trade-through rule like that included in Regulation NMS will in fact increase the use of limit orders. Regulation of Markets and Broker-Dealers The paper recommends that the SEC rethink the regulatory structure for exchanges and brokers. Specifically, it recommends eliminating direct regulatory responsibilities for exchanges and permitting qualified groups to become contract regulators for exchanges and broker-dealers. The paper states that this will improve the quality of regulation by introducing competition and will ease entry into the business of offering trading facilities, thereby benefiting investors. 3 The Market and Market Data The paper recommends that the SEC eliminate the requirement for consolidation of market data (i.e., quotations and transactions). The paper states that such reform is likely to provide investors with more and better data at a lower price, and thus fulfill the SEC's mandate to promote efficiency, competition and the promotion of capital formation. Dorothy M. Donohue Associate Counsel