FedFin Client Report

Thursday, January 21, 2020

FedFin Forecast: Gensler on the Go

Client Report: INVESTOR14

Executive Summary

In this report, we expand on prior forecasts to assess broad financial-regulatory and structure issues under the SEC's jurisdiction under what seems likely: a Chairman Gensler. His will be an activist SEC, one sure to throw broker-dealers, asset managers, and investment funds from the relative comfort of the last four years. Mr. Gensler is uniquely focused on investment funds after writing a book on the topic and will surely accelerate Commission work on the MMF-reform options outlined in the new PWG report (see *Client Report* **MMF16**) and on renewed consideration of asset-management interconnectivity with the banking system (see *Client Report* **FSOC16**). He is also determined to reverse losses to the Obama agenda under President Trump, especially on high-profile rules such as Dodd-Frank's incentive-compensation standards. The next SEC chairman will also surely accelerate initiatives on new priorities such as ESG investing and climate change and even undertake active assessments of the extent to which the Commission can promote "stakeholder capitalism." Mr. Gensler also has personal priorities such as crypto-assets, an issue on which he is sure to side with the tough stand taken by former Chairman Clayton and the approach laid out in another new PWG report, this one highlighting stablecoin risk and the need for new rules (see *Client Report* **CRYPTO16**). The SEC also plays a strong hand in key Treasury-market reform initiatives (see *Client Report* **TMARKET**). While other high-priority financial-policy issues are outside the SEC's purview, Mr. Gensler will regain his seat at the FSOC table, playing a critical role pressing for renewed consideration of big-bank regulation, incorporation of financial inclusion in FSOC determinations, and fintech.

Analysis

Key issues and likely action under a Gensler-led Commission include:

- MMFs: As noted, Mr. Gensler will further the SEC's shift to an agency willing to implement sweeping change. It is not yet possible, however, to forecast which of the options laid out by the PWG will be favored by the SEC, with both the PWG (on which Mr. Gensler would take a seat) and FSOC working through different policies on an inter-agency basis prior to delegating specific actions to the SEC and/or banking agencies. Mr. Gensler may also be open to SIFI designations for one or more very large asset-management firms. Although the Trump FSOC designation

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rule (see FSM Report **SIFI35**) makes designation more difficult, it does not in any way preclude it. Given Janet Yellen's strong support for nonbank-SIFI designation, we expect FSOC to revisit this rule but not to slow action on systemic firm or activity designations while doing so.

- Treasury-Market Reform: Much analytical work remains before specific initiatives advance, with the PWG and FSOC again taking the lead to coordinate inter-agency initiatives and determine the need for systemic intervention. We expect the SEC to move on a two-track path with regard to highly-leveraged hedge funds, supporting FSOC consideration of an activity or fund designation but moving on its own quickly to increase hedge-fund surveillance and enforcement. The same approach is likely for principal trading firms.
- Private Equity: Most of the issues Sen. Warren (D-MA) and others have raised re private equity require statutory change prior to SEC intervention. The most immediate concern in the sector is likely the tax changes Chairmen Neal (D-MA) and Wyden (D-OR) plan for carried interest when they turn to tax reform. As a House hearing on legislation to govern private-equity made clear (*see Client Report* **PE8**), progressives strongly favor statutory changes such as dividend, debt, and sector-investment limits, but moderate Democrats – the margin needed for enactment – do not. Although we expect major SEC research initiatives looking into questions such as the extent to which PE-owned entities use debt to fund dividends, not employment, the agency's authority over PE firms is limited absent statutory change or an activity-or-practice FSOC designation (quite possible).
- Climate Change: We expect rapid action by the SEC to adapt the FSB's approved climate-risk securities disclosures to U.S. law, rule, and political circumstances, issuing a specific proposal as quickly as possible.
- Cryptoassets: As noted, Mr. Gensler has been an active analyst of cryptoassets during his time out of office, testifying on this question in 2018 and making speeches and writing articles urging considerable caution for both investor-protection and systemic reasons. However, Mr. Gensler is more sympathetic to using blockchain in retail financial-service delivery, arguing it has significant payment-system and inclusion advantages. In addition to surely siding with the PWG report on stablecoin, Mr. Gensler will advocate for federal regulation of cryptoasset exchanges, establishing a considerably more stringent framework than now authorized by various states. Pending statutory change, the SEC will seek to govern aspects of crypto exchanges (e.g., custody powers, ability to interface with regulated broker-dealers and asset managers). Mr. Gensler is also likely to favor legislation Democrats introduced late last year to require cryptoasset firms to operate through a regulated charter, pressing to expand it to address securities and commodities considerations.
- Incentive Compensation: As noted, the Dodd-Frank Act required an inter-agency rulemaking limiting incentive compensation at large financial firms along with increased risk of forfeiture and clawback. None of the agencies in 2016 were necessarily enthusiastic about the new proposal, which reproposed an earlier version of the incentive-comp standards (see FSM Report **COMPENSATION33**). However, the agencies did intend to finalize the rule if only because they recognized the mandate to do so; now, new agency heads may be still more motivated to do so given incentive-compensation controversies over instances such as Gary Cohn's

refusal to comply with a clawback in the 1MDB matter. Chairman Brown (D-OH) also has a strong interest in compensation reform (see Client Report **COMPENSATION34**) and will press the matter. The SEC is well behind its statutory mandate also to issue a rule governing compensation clawbacks from all listed companies; this too should quickly advance.

- Diversity: In keeping with Biden Administration and Congressional racial-equity priorities, the SEC will consider mandating additional disclosures from listed companies on diversity representation on boards and senior management and perhaps also among vendors. SEC advisory committees will be reviewed on diversity grounds and a new panel focused on financial inclusion in securities and asset-management products is probable.
- Stakeholder Capitalism: Grand visions of public charters and mandatory employee ownership such as those envisioned in 2018 Warren legislation are unlikely to advance in this Congress. However, the turn of public thinking in favor of some form of stakeholder capitalism is powerful, giving the SEC a banner to fly as it pursues enforcement, investor-protection, proxy-adviser, disclosure, and research initiatives.

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