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June 18, 2019

The Honorable Carolyn Maloney
Chairwoman
House Committee on Financial Services;
Subcommittee on Investor Protection
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
House Committee on Financial Services;
Subcommittee on Investor Protection
2129 Rayburn House Office Building
Washington, DC 20515

Re: Legislative Proposals for June 19, 2019 Subcommittee Hearing

Dear Chairwoman Maloney and Ranking Member Huizenga:

On behalf of the North American Securities Administrators Association ("NASAA"),[1] I am writing to express my perspective on several legislative proposals that will be the subject of this week's Subcommittee hearing entitled "*Putting Investors First: Examining Proposals to Strengthen Enforcement Against Securities Law Violators.*"

America's capital markets function and grow in large part due to the trust that investors place in market participants and regulators. Maintaining that trust is essential to the continued primacy of these markets in a competitive global marketplace. Integral to maintaining that trust is the work of state securities regulators and our federal counterparts in investigating suspected investment fraud, and where warranted, pursuing enforcement actions. Keeping bad actors out of our markets serves not only the interests of investors, but also the businesses that rely on those markets to raise capital.

NASAA applauds the Subcommittee for holding this hearing and appreciates the opportunity to share our perspective regarding several of the proposals the hearing will examine.

1. The Stronger Enforcement of Civil Penalties Act of 2019 (Discussion Draft)

Federal securities laws currently limit the amount of civil penalties that the Securities and Exchange Commission ("SEC") can impose on an institution or individual. Specifically, under existing law, the SEC can only penalize individual violators a maximum of $181,000 and institutions $905,000 per offense.[2] However, hearings and experience have established that the present statutory

[1] The oldest international organization devoted to investor protection, NASAA was organized in 1919. Its membership consists of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] 15 U.S.C. §§77h-1(g), 78u-2(b), 80a-9(d), 80b-3(i). The penalty amounts are adjusted for inflation pursuant to 17 C.F.R. §201.1004. Further, in some cases, the SEC may calculate penalties equal to the gross amount of ill-gotten gains, but only if the matter goes to federal court, not when the SEC handles a case administratively.

limit on the SEC's authority to pursue civil penalties significantly ties the hands of the SEC in performing its enforcement duties.[3]

For enforcement to be effective as a deterrent, the costs to violators must be meaningful as a punishment. When it comes to protecting investors from bad actors, aggressive enforcement actions that penalize violators, disgorge ill-gotten gains, and provide compensatory damages and restitution for aggrieved investors, are the best deterrent and the only proven remedy.

The Stronger Enforcement of Civil Penalties Act of 2019 would increase the SEC's statutory limits on civil monetary penalties; directly link the size of these penalties to the scope of harm and associated investor losses; and substantially raise the financial stakes for repeat securities law violators. In order to maximize the deterrent for "repeat offenders," the bill also adds a fourth tier of monetary penalties for violations by a person that, within the five-year period preceding the violation: (1) was criminally convicted for securities fraud; or (2) became subject to a judgment or order imposing monetary, equitable, or administrative relief in a SEC action alleging fraud.

NASAA is pleased to support the Stronger Enforcement of Civil Penalties Act of 2019, as we have supported previous bipartisan legislation seeking to increase the per violation cap applicable to the most serious securities laws violations, and to provide the SEC with the discretion to increase the penalty in cases in proportion to the cost of the bad action. However, prior to passing this bill, we urge the Committee to further strengthen the legislation by expanding the new tier of penalties it establishes for repeat offenders to include persons who, in the previous five years, have become subject to an enforcement action by a *state* securities authority.

2. **To amend the Securities Exchange Act of 1934 to allow the Securities and Exchange Commission to seek and Federal Courts to grant restitution to investors and disgorgement of unjust enrichment (Discussion Draft)**

NASAA strongly supports efforts to pass legislation granting the SEC statutory authority to bring federal court claims for disgorgement and restitution.[4]

Under existing law, the SEC has authority to seek disgorgement through its own administrative proceedings but lacks explicit authority to do so in federal court. Traditionally, this has not been a problem, and the SEC for decades relied on federal courts' own inherent equitable powers to obtain disgorgement from wrongdoers. However, the necessity for Congress to explicitly set forth by statute the SEC's disgorgement and restitution authority in federal law has been brought to the fore by the U.S. Supreme Court's 2017 decision in *Kokesh v. SEC*.[5]

In *Kokesh*, the Supreme Court reversed decades of established jurisprudence by holding that SEC disgorgement operates as a "penalty," and therefore, is subject to the five-year statute of

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[3] See: Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Securities, Insurance and Investment. Hearing entitled "Strengthening the S.E.C.'s Vital Enforcement Responsibilities." May 7, 2009.

[4] See: NASAA's Legislative Agenda for the 116th Congress. P. 5. (www.nasaa.org/issues-and-advocacy/nasaa-legislative-agenda-for-the-116th-congress/)

[5] Kokesh v. SEC, 137 S. Ct. 1635 (2017).

limitations in 28 U.S.C. § 2462.[6] Furthermore, the Court in a footnote questioned the SEC's ability even to seek disgorgement in federal court.[7] *Kokesh* followed on the heels of another problematic Supreme Court decision, *Gabelli v. SEC.*[8] These twin decisions have severely limited the SEC's ability to recover investor funds from and to penalize fraudsters. Disgorgement and penalties account for a tremendous amount of money – $3.9 billion in FY 2018 – that is ordered to be paid by bad actors.[9] While the SEC was able to return $149 million in disgorged funds to harmed investors in FY 2018, SEC Chairman Jay Clayton stated that the *Kokesh* decision has led to the loss of approximately $900 million in disgorgement in filed cases for that fiscal year.[10] These are funds that should belong to investors.

While the *Kokesh* and *Gabelli* decisions have tied the hands of the SEC, which must adjust and prioritize its enforcement activities accordingly, the American public should not have to suffer as a result. Congress can and should override these rulings. The proposed legislation does just that by providing the SEC with the authority to seek various types of equitable relief in federal court. Specifically, the bill corrects these decisions by creating restitution authority, described as the amount of loss to investors, and preserving the ability of the agency to seek disgorgement. Further, the bill clarifies that none of these remedies are to be construed as a penalty under Chapter 143 of Part VI of Title 28, U.S. Code, which includes Section 2462, to reverse the five-year statute of limitations.

3. To establish a statute of limitation for certain actions of the Securities and Exchange Commission (Discussion Draft)

The draft legislation would amend Section 21 of the Securities Exchange Act of 1934 ("Exchange Act"), to allow the SEC to seek civil monetary penalties within 10 years after the alleged violation. As noted above, recent Supreme Court decisions, such as *Gabelli v. SEC* and *Kokesh v. SEC*, have constrained the agency's ability to penalize bad actors and recover funds for harmed investors. Specifically, *Gabelli* noted that the SEC is required to bring an action "within five years from the date when the claim first accrued" for the enforcement of any penalty, unless otherwise provided by Congress.[11]

While securities regulators should and do make every effort to bring actions in a timely matter, certain types of fraud are well-concealed and extend beyond the five-year period. Bad actors should not receive the benefit of their ability to hide their activity. Further, whereas statutes of limitation can

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[6] Section 2462 establishes a five-year statute of limitations for "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture," except as otherwise provided by Congress.

[7] *Kokesh* at n.3.

[8] *Id.* at 3 ("This Court has already held that the 5-year statute of limitations set forth in 28 U. S. C. § 2462 applies when the Commission seeks statutory monetary penalties.") (citing *Gabelli v. SEC,* 568 U.S. 442, 454 (2013)).

[9] See: SEC's Division of Enforcement 2018 Annual Report, https://www.sec.gov/files/enforcement-annual-report-2018.pdf (p. 5, 11).

[10] *Supra* note 9 at 12.

[11] 28 U.S.C. § 2462.

serve to protect against the prosecution of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared, in the case of securities violations, the financial and other records that are often central to securities violations do not do not tend to degrade over time. NASAA strongly supports the proposed legislation.

4. The Bad Actor Disqualification Act of 2019 (Discussion Draft)

The Bad Actor Disqualification Act would amend the Exchange Act to establish procedures for obtaining a waiver from automatic disqualification provisions in the federal securities laws. Specifically, under the bill, any entity seeking to obtain a waiver from automatic disqualification provisions required by federal law or regulation would be required to formally petition the SEC. Following a petition and public hearing, the SEC would be authorized to vote to grant the waiver if it determines such waiver (1) is in the public interest, (2) is necessary for investor protection, and (3) promotes market integrity. The bill also directs the Government Accountability Office to report on the SEC's current waiver process.

Congress is correct to explore steps that will better ensure that statutory "bad actor" disqualification provisions, such as for example, the disqualifications provisions established for Regulation D offerings by the Dodd-Frank Act,[12] are earnestly and consistently enforced. While waivers may be justified under exceptional circumstances, every petition for such waivers should be closely scrutinized, and waivers should be granted only in the exception and when clearly appropriate.

NASAA strongly supports the proposed legislation.

5. The PCAOB Enforcement Transparency Act of 2019 (Discussion Draft)

The PCAOB Enforcement Transparency Act would amend the Sarbanes-Oxley Act of 2002 to make the Public Company Accounting Oversight Board's ("PCAOB") disciplinary proceedings open to the public. The PCAOB was established by Congress to oversee auditors whose reports are filed with the SEC in order to protect investors and further the public interest in the preparation of informative, fair, and independent audit reports on the financial statements of public companies.

Adjudicatory proceedings to determine whether an auditor or audit firm should be sanctioned for violating applicable rules or standards are an important component of the PCAOB's oversight authority. However, unlike the disciplinary proceedings of other comparable regulators, current law provides that PCAOB cases may not be made public until they are appealed to the SEC. Preventing such proceedings from being public is unnecessary and may have adverse consequences for the investing public, audit committees, the auditing profession, the PCAOB, and other interested parties.

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[12] On July 10, 2013, the SEC adopted "bad actor" disqualification provisions for Rule 506 of Regulation D under the Securities Act of 1933, to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result of the "bad actor" disqualification, an offering is disqualified from relying on Rule 506(b) and 506(c) of Regulation D if the issuer or any other person covered by Rule 506(d) has a relevant criminal conviction, regulatory or court order or other disqualifying event that occurred on or after September 23, 2013, the effective date of the rule amendments.

NASAA continues to support the proposed legislation and related steps to ensure transparent regulatory and enforcement processes.[13]

6. The Corporate Management Accountability Act of 2019 (Discussion Draft)

The Corporate Management Accountability Act would direct the SEC to issue final rules requiring publicly traded companies to "disclose whether the reporting company, in order to align the incentives of those managing the reporting company with the incentives of the shareholders of the reporting company, has established procedures to recoup from compensation paid to, and to withhold from future compensation paid to, any named executive officer all or a portion of the cost of any covered fine or similar penalty that has been paid by the reporting company" as a result of conduct by the named executive. Under the bill, publicly traded companies that do not have such procedures would be required to explain why not having such procedures is necessary for the benefit of its shareholders.

The legislation is premised on the notion that shareholders' interests tend to align with the public's interest in seeing that executives who perpetrate criminal and other violative conduct are held directly accountable and responsible. We agree with that view, and we support the legislation. We also urge Congress to consider whether the required disclosure should be broadened to include information about policies to recover legal costs associated with the relevant penalty, given that the cost of defending against such claims can be considerable.

Thank you for your consideration of NASAA's views. If we may be of further assistance, please do not hesitate to contact me or Michael Canning, NASAA's Director of Policy and Government Affairs, at (202) 737-0900.

Sincerely,

Michael S. Pieciak
NASAA President,
Commissioner, Vermont Department of Financial Regulation

[13] NASAA has previously urged Congress to enact legislation to make PCAOB disciplinary proceedings initiated against accounting firms and individual auditors "open to the public." (http://www.nasaa.org/9090/letter-of-support-for-s-1907-the-pcaob-enforcement-transparency-act-of-2011/)