Speech by SEC Commissioner: Keynote Address at the Society of Corporate Secretaries and Governance Professionals 65th Annual Conference

by

Commissioner Kathleen L. Casey

U.S. Securities and Exchange Commission

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Thank you so much. I am extremely pleased to join all you this morning and in such a magnificent setting. Such awesome, natural beauty can't help but inspire. And a little inspiration can't hurt these days. Indeed, I was struck by the theme of this important conference — Rising to the Challenge — because it so aptly captures the daunting nature of the current regulatory environment.

Corporate secretaries and governance professionals throughout the country certainly have had their plates full over the past year with all of the corporate governance and other changes to come out of Dodd-Frank. While I cannot help you to steer your companies through these changes, I hope to give you some insights today into the state of play at the SEC, some observations and views on the current trends in regulation that we have all been witnessing from the federal government over the past year or more, and a few thoughts on some of the primary issues that will be of concern to public companies and investors in the near future.

First, however, I need to provide the standard disclosure that my remarks today represent my own views, and are not necessarily those of the SEC or my fellow commissioners.

State of Play at the SEC

As you are no doubt aware, we are now approaching the first anniversary of the Dodd-Frank Act. As of June 1, according to an analysis by Davis Polk & Wardwell, who seems to be the scorekeeper of record on these numbers, the SEC had proposed 41 rules required by Dodd-Frank, had adopted an additional nine rules, and had missed statutory deadlines for an additional eight rules. Earlier this week we finalized three rules required by Dodd Frank on the regulation of private funds and family offices. In addition, there are an additional 35 required rules for which the statutory deadline had not yet passed.

So, we have a way to go still.

I am on record for the view that satisfying statutory rulemaking deadlines is far less important than ensuring that the rules that we adopt are well-considered, so the fact that we have missed some deadlines, and will continue to miss more deadlines, is intrinsically neither a "good" nor a "bad" fact. Many of our required rulemakings are extremely complex and will have far-reaching consequences for efficiency, competition and capital formation, and may have costs that are difficult to foresee or benefits that are illusory. So I continue to believe that these considerations cannot take a back seat to overly aggressive deadlines.

At the same time, I recognize that the uncertainty associated with a delay of required rulemakings can also be harmful to our markets and our economy. The Commission has taken steps to attempt to mitigate some of this uncertainty. In particular, we recently provided guidance that makes clear that substantially all of the requirements of Title VII under the Dodd-Frank Act that are applicable to security-based swaps will not go into effect on July 16. In addition, we granted temporary relief from compliance with most of the new Exchange Act requirements under Title VII that would otherwise apply on July 16.

Nevertheless, uncertainty will inevitably persist in many areas until we have adopted final rules required under the Act. This uncertainty will affect substantially all of the products, markets, and entities that we regulate, including most notably OTC derivatives; credit rating agencies; and asset-backed securities to name a few.

Relatedly, there remains broader uncertainty over how the newly formed Financial Stability Oversight Counsel (FSOC) will exercise its authority to designate as systemically important certain entities and institutions, and thus subject them to enhanced prudential standards, including capital requirements, and consolidated supervision by the Fed. This uncertainty will remain until the FSOC adopts final rules[1] setting forth the criteria, processes and procedures that will govern the consideration of firms for such a designation and actually makes these designations.

All of this uncertainty, of course, contributes to a more cautious market environment, which in turn further slows economic recovery.

Federal Activism and Prescriptiveness

Various levels of uncertainty for public companies also attend some of the rules that the Commission has recently adopted or is currently considering. This uncertainty arises as issuers, investors and other market participants wait to see how various rules that we have adopted will play out — as in the case of the new whistleblower rules and say-on-pay; as they await the adoption by the Commission of final rules — as in the case of listing requirements relating to compensation committees and the use of compensation advisers, so-called "pay equity" disclosure, and compensation claw-backs; and as we all await the outcome of pending litigation in the case of the proxy access rules.

Yet uncertainty is clearly not the only concern of public companies as the Commission and the D.C. Circuit consider these rules. Of primary concern to many issuers and investors is the content of these rules.

I doubt you will be surprised to learn that I believe these rules, and the statutory provisions that in some cases require them, represent troubling moves in two key respects: First, toward activism by the federal government in corporate affairs, where in the past we have been content to allow private ordering and simply to require complete and accurate disclosure and, second, toward prescriptiveness in the rules implementing the Dodd-Frank Act, where more measured rule-making that does not exceed the new law's requirements or go beyond that which is necessary to implement the Act would be more appropriate.

These moves toward federal activism and prescriptiveness have been underway at least since the Sarbanes-Oxley Act of 2002, but have gained significant momentum since the financial crisis, as reflected in countless provisions under the Dodd-Frank Act and other rules that we have proposed or adopted since 2009.

Nowhere are these trends more evident than in the context of corporate governance.

The animating principle for a number of these provisions is shareholder empowerment — which I believe reflects more than just giving greater effect to shareholder voice and promoting important dialogue between shareholders and the companies they own. Rather, it more fundamentally reflects the transfer of corporate power from the board of directors to the shareholders themselves. This concept underlies a laundry list of policy choices that Congress and the Commission have made in recent years, including: proxy access, say-on-pay and say-on-golden-parachutes, recent no-action letters relating to shareholder proposals, and pay-equity and pay-for-performance disclosures.

Related to the embrace of shareholder empowerment as the basis for policy choices is a fundamental distrust at the federal policymaker level in the effectiveness of state-law mechanisms, such as fiduciary duties, to drive the decisions and actions taken by boards of directors and executives of public companies. This distrust is reflected in such policy choices as the new whistleblower provisions, mandated stock exchange listing standards relating to compensation committees and the use of compensation advisers, and compensation clawback requirements.

Notably, the very notion that the federal government should take any position on the relative powers of shareholders and boards of directors in privately-owned companies is a dramatic change in the understanding of the role of the federal government. The distribution of power in business organizations has, since long before the SEC was created, been a matter of state law and private agreements. And, to the degree the federal government is mandating or prescribing governance standards, it actually deprives shareholders of choice in these matters.

Yet this animating principle is based on a false notion of shareholders and how they exercise their rights. The overwhelming majority of individual shareholders do not vote at annual meetings, and many institutional shareholders simply farm out their voting decisions to proxy advisory firms. As a result, there is a risk that proxy advisers may wield undue influence in corporate governance, potentially outweighing the influence of the shareholders that hold true economic rights in a company. Moreover, because of the operation of some of our antiquated rules, like those relating to corporate communications with so-called objecting beneficial owners, companies have little ability even to seek greater shareholder involvement in these decisions.

You are all well aware, I am sure, of the Commission's Concept Release last year relating to the U.S. proxy system, which spelled out these and other weaknesses in some detail. I was pleased to hear the Chairman's commitment in her public statements on Tuesday to return to these issues soon. While I look forward to considering proposals to address the potential conflicts of interest at proxy advisory firms and the questions regarding the accuracy and transparency of their research and voting recommendations, I do believe we must look at the proxy voting system holistically because of its complex mechanics.

More fundamentally, Dodd-Frank signals a significant shift away from a regulatory approach based on disclosure and transparency as a primary means of influencing market conduct and promoting investor protection. Indeed, this shift reflects a different ruling philosophy regarding the role of the federal securities laws.

With Dodd-Frank you see a continuing trend toward the federalization of corporate law, a tendency toward prescriptive over disclosure-based solutions, a failure to properly identify market failures as a basis for government action, an erosion of the historic differences in approach between regulating private and public markets and the underlying rationale underpinning differences in levels of protections for sophisticated and retail investors, and expansion of the objectives and purpose of the securities laws. Beyond corporate governance, these are borne out, for example, in the new law's provisions related to OTC derivatives; securitization; private fund registration and regulation; and specialized disclosures.

Further, the Commission itself, in exercising its discretionary authority under the law, has in several instances chosen to go beyond what the statute requires or to be more prescriptive in its rules than required by the law. For instance, the Dodd-Frank Act leaves a fair amount of discretion to the SEC and CFTC in filling out the law's clearing, trading and trade reporting mandates for swaps transactions. In my view, however, our approach to some of these regulations reflects an instinct to be more prescriptive than is required or necessary.

For example, the Commission has proposed rules that would heavily rely on ownership and governance restraints as a primary means of mitigating potential conflicts, which could operate to reduce or prevent access to clearing or trading. This is so even though other provisions of the law are expressly designed to ensure access to clearing and swap-execution facilities (SEFs). Moreover, in several instances, the Commission has decided to micromanage the operations of clearing agencies and SEFs and to propose additional requirements for their Chief Compliance Officers beyond what Dodd-Frank requires.

I believe that getting these rules right requires that we let our developing experience and understanding of these markets inform the development of the regulatory regime. An overly prescriptive regulatory architecture designed with little understanding of these markets, and the products and participants in these markets, could have severely harmful effects on American competitiveness.

If addressed imprudently, we may end up with a highly prescriptive regulatory regime and no regulatees. Not only will our competitors in Asia and Europe be more than happy to have the business, and the jobs, we will make it more difficult and expensive for American companies that use derivatives to hedge their business, interest rate, credit, and currency risks. Underlying these policies is the presumption is that there are good, sound reasons for this activism and this increased level of prescriptiveness; in my view, however, policy-makers simply have not made the case that they are necessary or advisable.

Overly prescriptive, static, one size fits all rules in a dynamic system run the risk of design failure, and promoting homogeneity that can lead to greater systemic risk. They burden investors to the degree that they do not meaningfully enhance decision-useful information or protection. They increase regulatory costs, discriminate disproportionately against smaller firms, and can act as barriers to entry minimizing the disciplining effect of competition. To the degree this results in greater consolidation, you have greater concentration of risk. To the degree the rules hardwire structures and outcomes, they stymie innovation, capital formation and growth.

Some Specific Rules and Issues

I want to turn now to some specific rules and other issues that will affect your companies in the upcoming months and years, in particular our recently-adopted whistleblower rules; the proxy access regime that is currently before the D.C. Circuit; issues that have recently come to the fore relating to large private companies and their trading in "semi-public" markets; and finally, IFRS.

Whistleblower Rules

Keeping with the theme that federal policy-makers have taken too strong a hand in the affairs of privately-owned companies, I am very concerned that the whistleblower rules, which were required by the Dodd-Frank Act, strike the wrong balance between the federal role in ferreting out wrongdoing, on the one hand, and deference to companies' internal compliance policies and procedures, on the other.

Following S-Ox, public companies invested significant time and money to develop and implement internal reporting mechanisms designed to uncover and address potential securities law violations early. The effectiveness of internal compliance procedures relies on the robust flow of information. Unfortunately, the whistleblower rules that we recently adopted create huge financial incentives for employees to bypass these systems.

Because of these incentives, the volume of complaints is likely to be tremendous, and all reports to the SEC must be evaluated — likely adding significant costs and diverting staff resources from other priorities. Furthermore, the SEC has inferior access to information compared to companies that are the subject of complaints. As a result, even under the best of circumstances, the public investigative process is inherently much slower than internal processes. Thus, violations that could be caught and corrected quickly through a company's internal investigation policies may last longer and grow more serious.

It is too early to know how the whistleblower program will play out. The Commission announced in February that we had hired Sean McKessy to head the Office of the Whistleblower, and I am confident in his abilities. Nevertheless, because the Commission had to take positions on many difficult issues, the program is likely to be difficult to administer effectively, and there will likely be unintended consequences. I also fear that the program will be difficult to measure for effectiveness. In many ways, much depends on how the enforcement division chooses to exercise its discretion under the whistleblower program. Thus, it will likely be some time before we are able to fully gauge its effects.

Proxy Access

Moving on to proxy access. Like you, we are all waiting with baited breath for the D.C. Circuit to hand down its decision. If the court does strike down the rules, I would certainly expect a period of internal scrambling to figure out how to respond. The nature of that response, of course, and how long it takes for the Commission to respond, will depend on the basis of the court's decision. A decision that strikes at the substance and rationale for the rules themselves will obviously require significant "soul searching" by the Commission before it can figure out its next step. I would expect that a decision based on a narrower point, such as the adequacy of our cost-benefit analysis, may simply result in taking another "bite at the apple" to address the particular weaknesses identified, without significant changes to the rules.

I would, of course, love to see the Commission back away from the mandated federal regime embodied in Rule 14a-11 in favor of a state law-based, private ordering approach reflected in amendments to Rule 14a-8(i)(8) under the

Exchange Act. Such an approach would, I believe, achieve the primary goal of allowing investors a greater role in the nomination and selection of directors, and thus the ability to hold directors "accountable," while preserving the fundamental state-law right of shareholders to determine for themselves the level of proxy access that is appropriate for the companies that they own.

Further, were the Court ruling to have the effect of supporting such an approach or outcome, it would also perhaps temper future efforts to impose similar federal mandates.

So, we wait and see.

Public / Private Considerations

In the past eight months or so, since news became public of a potential private placement of Facebook shares to a group of accredited investors led by Goldman Sachs, there has been a lot of discussion surrounding a number of issues relating to private placements and the trading of privately-issued shares on trading platforms such as SharesPost and SecondMarket.

In particular, these events drew the public's and policy-makers' attention to the 500-shareholder rule, raised questions about the appropriate level of regulation of, and disclosure required by, private companies with shares traded on these online trading platforms, and drew attention to the ban on general solicitations in private placements.

While our Division of Corporation Finance has had many of these issues on its radar screen for years in some respects, it is safe to say that these events brought these issues prominently into the public arena. The 500-shareholder rule has been under pressure for some time, as the rule dates to a time when shares of public companies were primarily held by investors directly, whereas the overwhelming majority of shares of public companies are now held in "street name." Shares of private companies, conversely, generally continue to be held directly.

As a result, public companies may be able to "go dark" when the number of record owners of their shares falls below 300, even though the number of beneficial owners may be many times that number, whereas private companies can approach 500 shareholders — triggering a requirement to file reports with the SEC — fairly quickly. In light of these factors, our reexamination of these rules is clearly appropriate.

The desire of private, growing companies to delay going public for as long as possible no doubt reflects a calculus involving a number of factors specific to each company. Primary among these factors for many companies, however, is the cost of being public. This cost has increased dramatically in recent years following two rounds of substantial growth of securities regulation — pursuant to S-Ox nearly a decade ago and, most recently, pursuant to Dodd-Frank.

The trend of companies delaying going public goes hand-in-hand with statistics that reflect fewer IPOs by U.S. companies in the United States in recent years, and an increase in the number of U.S. companies listing securities and raising capital outside the United States. The emergence of private trading platforms such as SharesPost and SecondMarket is an outgrowth of this phenomenon. To the extent that companies delay an IPO due to high compliance costs, these platforms enable investors seeking liquidity to trade securities with investors, meeting certain financial or sophistication standards, that seek investment opportunities in pre-IPO companies. Nevertheless, the emergence of these trading platforms has also raised a number of questions, including whether these investors require the protections afforded by the financial disclosure and other requirements of the federal securities laws.

A final issue relating to private placements that has come to the fore in recent months is the Commission's longstanding prohibition on general solicitations. In particular, the question has been posed: if private placements are limited to accredited investors, how are non-accredited investors harmed by exposure to general solicitations? And if there is no harm to the investing public, does the ban on general solicitation unnecessarily hinder capital formation by private companies?

The Chairman has requested that the staff look at these, as well as other, questions relating to capital formation, particularly as they apply to smaller and emerging companies, and I look forward to the results of this analysis.

IFRS

The last topic I want to discuss with you today is the further incorporation of IFRS in the U.S. financial reporting system by U.S. issuers. The Commission has long recognized the clear benefits of a single set of high-quality global accounting standards. Capital markets are increasingly global, with U.S. private assets invested in foreign securities as of December 31, 2009 of $5.47 trillion.[2] In addition, the growing capital flows into emerging markets in recent years cannot be ignored.

As IFRS is increasingly used abroad, it follows that an increasing number of U.S. investments will be in IFRS-reporting entities. Relatedly, foreign investments in U.S. securities other than Treasury securities were $5.29 trillion as of December 31, 2009.[3] As a result, accounting standards that provide investors with highly comparable, decision-useful information about businesses without regard to their domicile will facilitate well-informed capital allocation decisions among investment opportunities across the globe, leading to continued improvements in the efficiency of the global capital markets.

Additionally, a single set of high-quality accounting standards will significantly reduce the burdens and costs for multinational corporations of reporting their financial results under multiple accounting systems. The Commission has already made the determination that IFRS, as issued by the IASB, are of high quality. This determination was necessary to our decision in 2007 to permit foreign private issuers to make filings with the Commission using financial statements prepared in accordance with IFRS without reconciliation to U.S. GAAP.

Pursuant to the Work Plan that Commission staff issued in February of last year, the staff continues to analyze questions relating to whether, and how, to incorporate IFRS into the U.S. financial reporting system for U.S. issuers. In October 2010, the staff released an update under the Work Plan, and in May, the Office of the Chief Accountant issued a staff paper seeking comments on an additional potential approach to incorporation of IFRS by U.S. issuers.

The Commission is slated to make a decision on these questions this year, and we can no longer kick the can down the road. I believe the choice is clear — the Commission must decide to incorporate IFRS for U.S. issuers. In addition to the benefits of IFRS that I have already mentioned, the risks of not moving forward with IFRS for U.S. issuers are simply too great.

There can be no doubt that the United States has a significant stake in the future of IFRS. The magnitude of U.S. investments in companies reporting under IFRS requires that, for the protection of investors, we ensure that IFRS continue to be of high-quality and that IFRS continue to be comparable across borders. History has shown us that, in the absence of U.S. involvement and leadership, carve-outs and divergence by individual nations from IFRS, as issued by the IASB, begin to emerge. In the absence of a credible step by the United States to increase its use of IFRS, however, our ability to influence

IFRS, and thus ensure their continued quality and comparability, will quickly dissipate. Furthermore, U.S. involvement with IFRS ensures that work will continue on convergence between IFRS and U.S. GAAP, thus maximizing comparability between the two systems.

Some people have objected that the incorporation of IFRS for U.S. issuers means the United States would cede its sovereignty to the IASB, but the SEC will always be the decision-maker over financial reporting standards in the United States. Others object that IFRS fails the test of being completely comparable, pointing to examples in India and Brazil. Yet, we cannot permit the perfect to be the enemy of the very good, nor can we simply walk away because the work is too hard; instead, we should remain engaged and capitalize on our ability to influence the standards to improve comparability. While I believe that the United States must provide for reporting under IFRS by U.S. issuers, I believe that we can and should give some issuers the option to continue to report under U.S. GAAP.

One of the concerns that has been expressed since we first issued the “Road Map” in November 2008, from smaller reporting companies and other companies that have no international operations or aspirations, is that the transition to IFRS will be burdensome and impose costs without providing them with any commensurate benefits. I understand these concerns, and it makes sense, in my view, to allow these issuers to opt out of IFRS, at least initially, if not permanently. Providing optionality would preserve the benefits of IFRS, ensure continued U.S. influence in the development and preservation of IFRS, and avoid unnecessary costs for smaller U.S. issuers.

Furthermore, the experiences that we gain in the initial transition to IFRS and the continued development of IFRS will pay dividends in later years. These experiences can inform a later decision whether to require the transition to IFRS for all U.S. issuers. The transition to IFRS and the initial years of reporting under IFRS will lead to increased IFRS expertise and capacity in the United States, including auditor expertise, issuer proficiency, and investor understanding and comfort. Continued convergence of IFRS and U.S. GAAP during these early years will further reduce the differences between the two systems, making a later transition by other companies less burdensome and costly.

Some commentators object to providing optionality on the basis that it would lead to a “two-GAAP” world. My response is that we are already in a two-GAAP world. The Commission already permits foreign private issuers to report using IFRS. Furthermore, in light of the global nature of our capital markets, investors, public accountants and other market participants already need to know both U.S. GAAP and IFRS.

The Commission’s decision this year is a critical one and it is being closely watched by other jurisdictions around the world. In this area, our global leadership still matters greatly. I hope we rise to the challenge and continue to lead.

Conclusion

I would like to once again thank the Society for the invitation to speak to you today. I would also like to let you know how important your input is at the Commission. Your members offer particular first-hand expertise, knowledge and perspective that is extremely informative to our rulemaking efforts. So I encourage you to continue to provide the high quality and thoughtful comments you have to date.

I am happy to entertain a few questions in the time that we have remaining.

[1] On Jan. 19, 2011, the FSOC approved a proposed rule outlining the criteria that will inform the FSOC's designation of such firms and the procedures the FSOC will use in the designation process. *Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 4555 (Jan. 26, 2011).

[2] Source: Dept. of Commerce, Bureau of Economic Analysis (available at http://www.bea.gov/newsreleases/international/intinv/intinvnewsrelease.htm).

[3] *Id.*

http://www.sec.gov/news/speech/2011/spch062411klc.htm