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INSIGHT: The SEC's Failing Report Card on Regulatory Losses

BY THOMAS G. HUNGAR

The Securities and Exchange Commission has lost its way. In the span of just 11 days in June, the SEC suffered a string of three losses in court challenges to regulatory initiatives emanating from its Division of Trading and Markets and aimed at advancing the interests of the security industry's largest brokers.

A commission win later in June in *XY Planning Network LLC v. SEC* (2d Cir. June 26, 2020), upheld a regulation that weakened protections brokers owe to their Main Street customers.

Congress and the public should wonder why the agency's current leadership is systematically attempting to protect the most powerful players in the securities industry at the expense of publicly traded companies, securities exchanges, and the investing public.

These recent court decisions were issued by respected judges across the ideological spectrum. *See NASDAQ Stock Mkt. LLC v. SEC* (D.C. Cir. June 5, 2020); *NASDAQ Stock Market LLC v. SEC* (D.C. Cir. June 5, 2020) (per curiam); and *New York Stock Exchange LLC v. SEC* (D.C. Cir. June 16, 2020).

One of the invalidated initiatives was, as U.S. Court of Appeals for the D.C. Circuit Senior Judge Edwards (a Carter appointee) explained, ''an aimless 'one-off' '' pilot program that ''imposes significant, costly, and disparate regulatory requirements on affected parties'' merely to investigate ''whether there *might* be a problem.''

The SEC chose to impose an ''exogenous shock'' on the securities markets simply to satisfy its own curiosity, even though the pilot program, the Transaction Fee Pilot for NMS Stocks, threatened to harm public companies and investors, reduce market liquidity, and confer unfair competitive benefits on the off-exchange ''dark'' trading venues owned by some of the securities industry's biggest players, while competitively hobbling the securities exchanges that help to regulate them.

Another invalidated regulatory measure attempted to give the Securities Industry and Financial Markets Association, an industry lobbying group, the power to overturn fees that the SEC itself had reviewed and allowed to take effect years earlier, again for the benefit of the largest securities firms. And in the third case, the court rejected the commission's attempt to insulate from judicial scrutiny still more burdensome regulatory impositions benefiting the same large firms.

SEC Approaches Designed to Benefit Just One Segment of the Market Rather than reducing regulatory burdens, as one might expect from the current administration, the SEC has attempted to use the regulatory process to pick winners and losers. In all three cases, however, the agency proceeded without adequately considering whether Congress had actually given it the powers it tried to use.

Moreover, this one-sided approach designed to benefit only one segment of the market represents a fundamental departure from past practice and should raise red flags for all market participants, and for Congress.

For decades, the SEC's regulatory initiatives tended to be either incremental or driven by market consensus, supported by exhaustive discussion and meaningful consideration of public comments. That approach was consistent with Congress's vision of an independent oversight agency designed to represent differing viewpoints while promoting a model of self-regulation and competition.

Unfortunately, the commission's current approach disrupts that vision. The division's most substantial regulatory actions have proceeded with little consideration of competing views, instead deferring to the wishes of narrow special interest groups who, unlike

exchanges, have no regulatory mandate to ensure the health and efficiency of markets.

Indeed, after establishing an Equity Market Structure Advisory Committee designed to develop a consensus among market participants on a range of issues, the commission proceeded to adopt regulations that contradicted the committee's recommendations.

One might expect that the commission would have learned lessons from last month's setbacks, but it is now proceeding with more of the same. In February, the SEC proposed creating a ratemaking board, composed of exchanges and their customers, that would set the fees that exchanges can charge for many of their products, with the whole price-control process overseen by an army of bureaucrats.

Although members of Congress and even one commissioner recommended that the agency delay all rulemakings not designed to assist the economy in coping with the ongoing pandemic, and although commenters representing public companies, securities traders, institutional investors, and exchanges all begged for more time to evaluate the massive proposal, the commission has ignored these pleas.

As with its recently invalidated measures, however, the commission would be better-served by pausing to examine whether this massive regulatory intervention is warranted or authorized. Despite the stresses created by a pandemic and resulting recession, the U.S. securities markets are operating more efficiently than ever, and costs to Main Street investors remain historically low.

Thus, the commission's latest proposals are another overbearing regulatory solution in search of a problem.

How can the SEC correct course?

First, it should cease tailoring its regulatory initiatives to the desires of powerful special interest groups.

Second, the commission should carefully evaluate input from public companies, investors, and exchanges.

Third, the commission should return to a consensus-based approach to rulemaking.

And finally, the commission should focus on identifying and addressing *real* problems, not seeking out hypothetical ones.

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