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INVESTOR RELATIONS: A COMMUNICATIONS CLEARINGHOUSE

A TALK WITH FORMER NATIONAL INVESTOR RELATIONS INSTITUTE CHAIR VALERIE HAERTEL

By John Wilcox

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Companies in today's market face growing pressure from institutional investors to provide more substantive explanations of business strategy and more detailed information relating to environmental, social, and governance (ESG) factors that materially affect the business. At the same time, shareholders are complaining about excess disclosure—reports with too much standardized information and too many details that obscure meaning.

Instead of more disclosure, investors want better communication in the form of a narrative that "tells the company's story" and paints a coherent picture of the company's operations, governance, financial and non-financial risk factors, culture, competitive position and long-term strategic goals as well as its financial performance. Behind this demand is the conviction shared by many investors that a company's ability to tell its story convincingly is a reliable indicator that management and the board know what they are doing and are running the enterprise effectively.

The demand for this type of narrative is becoming widespread. It is the official goal of the International Integrated Reporting Council (IIRC), which leads a global movement to reform how companies think and communicate. It is also a goal of the European Commission, which has been pressuring issuers to improve the quality of their explanations and provide more substantive information in sup-

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port of their ESG policies. The emphasis in the EU's voluntary, "comply-or-explain" governance system now falls heavily on "explain."

In the U.S., with its rules-based governance system and detailed disclosure rules, the concept of an individualized narrative gives rise to legal uncertainties. This is particularly the case when the narrative contemplates the type of forward-looking information that institutional investors want but that disclosure rules discourage. Even in the U.S., however, customized communication has made significant progress, much of it outside the framework of regulated disclosure documents. "Engagement" has become an alternative communication path that is endorsed by both companies and institutional investors.

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U.S. issuers are dealing with these expanded informational demands in different ways. One of the most successful solutions has been developed by Valerie Haertel, a former chairman of the National Investor Relations Institute (NIRI), who during her career has created a role for the IR department as a "communications clearinghouse." Working directly with her peer executives in different departments, she has taken an approach to investor relators that is more strategic and that addresses the full scope of informational needs of investors, including those on the governance side of the house.

I met recently with Valerie to discuss how her communications clearinghouse worked in practice.

John Wilcox: Valerie, for many years people have been predicting the convergence of investor relations and corporate governance. Is that finally happening?

Valerie Haertel: Yes. I would describe it as an informal evolution rather than a deliberate effort to converge. The trend started primarily at

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larger, more progressive companies, although I see that there is increasing interest at companies of all sizes. In fact, this has become an important trend that the NIRI has recognized and is addressing through educational programs. The demand from institutional investors for information about ESG practices has been a big stimulus.

If you were to attend the annual conferences of both NIRI and the Society for Corporate Governance you would find that the topics on their agendas are similar—Environmental, Social & Governance (ESG), shareholder activism, engagement, stewardship, director accountability, short-termism, and so forth. Since investor relations (IR) and governance professionals are dealing with this common set of challenges, there is more collaboration and the corporate roles are naturally converging.

Since investor relations (IR) and governance professionals are dealing with this common set of challenges, there is more collaboration and the corporate roles are naturally converging.

But IR and governance are separate disciplines and are assigned to different executives or departments at most corporations. Doesn't that create a problem?

It should not be a problem if IR officers are able to collaborate effectively with their business partners. That is the approach I have taken.

OK. You describe your Investor Relations role as a "clearinghouse function." What do you mean by that?

Well, my primary role leading Investor Relations has always been the traditional one of financial communications. Once an IR strategy is put into place, I work with the CFO and CEO organizing communications with the buy- and sell-side, preparing quarterly earnings releases, conducting IR road shows and fielding calls from investors. In addition to that traditional role, I have made a point of working directly with other departments across the company to collect and communicate information about issues of concern to shareholders that are not purely financial.

I use the term "clearinghouse" to emphasize the way that internal collaboration works across departmental boundaries, thereby enabling the company to present a more comprehensive, accurate and unified picture.

How did the clearinghouse work in practice?

I collaborated directly with a number of corporate business partners and line of business leaders in most of the companies where I worked. One was the Corporate Secretary. I provided data and analytics about ownership, including the feedback I received from my daily contacts with shareholders and analysts.

In my role leading IR at several financial services companies, I worked directly with the governance professionals who oversaw investment stewardship and proxy voting for the asset management groups, as well as the individuals responsible for Corporate Social Responsibility who oversaw activities related to sustainability and reporting. Those relationships and input really helped me to understand how investment professionals think and react to various ESG issues. Additionally, the business unit leaders helped me to better understand the nuances and complexities of the various operating businesses. These interdepartmental relationships enabled me to bring together diverse perspectives in shaping the content of the investor relations and engagement programs. This is what I mean by a clearinghouse role.

Are Investor Relations road shows being expanded to reach stewardship teams as well as portfolio managers and analysts?

Yes. During the course of my career, I have gotten to know the stewardship teams at the major institutional investors and I have made a practice of including them in investor outreach programs. I found that interest in governance and ESG issues has been increasing in the U.S. and tends to be greater on the buy-side than the sell-side, unless there is activist activity and governance is being questioned. At several firms, I participated with management and board members in engagements with shareholders. Typically, the Corporate Secretary's office and I would reach out together to the governance decision-makers on the buy-side outside of and during the proxy season.

This practice is becoming an increasingly important part of the investor relations practice generally as buy-side analysts and PMs are also better coordinated on these issues. Depending on the circumstances, engagement accomplishes two goals. First, it is a great way to get candid feedback from shareholders. That is the listening part. Second, it's a great way for shareholders to get to know the management team and in some cases, board members personally. Conference calls are useful and efficient, but face-to-face meetings are the most effective way to build trust over the long term.

I should mention that in my roles leading IR programs, I was directly involved in the preparations and mechanics of the annual meeting, including being a contributor to the proxy statement, which gave me another opportunity to build personal relationships. I think that the annual meeting is a meaningful investor relations event because governance is on the agenda and the board of directors is in the spotlight. IR can add a lot of value in the preparation process leading up to the annual meeting.

Do you treat indexed investors differently from active managers?

Yes and no. Active managers and the sell-side are still the primary audience for financial communications, quarterly earnings announcements and the like. But outreach to index investors and their stewardship teams is not just limited to ESG topics and proxy votes. Index investors have made it clear that they want to understand business strategy and financial performance as well as ESG policies. From their perspective as long-term "permanent" investors, there's no separation between financial and non-financial factors affecting the business. Both active and indexed investors want to know about both. That being said, active managers generally require more frequent and detailed information on the strategy, financial performance and outlook.

What is your view about the debate over short-term versus long-term business goals?

That is an easy question for me to answer.

It is imperative that companies build and run their business for the long-term. NIRI has recently issued some updated guidance related to quarterly earnings guidance, focusing companies on the importance of managing for the long term. In my view, companies shouldn't manage to meet short-term street expectations, or run the business based on how they think the stock market will respond in the short-term. It is important to understand investor perceptions and to communicate strategy and priorities clearly in order to ensure a realistic assessment of future performance by investors.

The market has changed during the past decade—trading activity and stock prices are now influenced by technical factors that often have nothing to do with a company's intrinsic value. So, I agree with the statement that the Wall Street tail shouldn't wag the business dog. Luckily, in today's market many investors also agree and explicitly support a long-term focus. Sustainability is also an increasingly important and shared goal for companies and for the stable, long-term shareholders they want to attract.

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Many commentators recommend the elimination of quarterly earnings reporting as a means to combat short termism. Some high-profile companies have done so. What is your view?

I've heard the argument that bi-annual reporting would keep investors more focused on the long term. But my experience is that both buy and sell side investors prefer quarterly earnings reports. From the corporate perspective, quarterly reporting keeps the leadership team and employees focused on strategic direction and results, creating discipline and enabling course corrections if necessary. However, to keep investors more focused on the long-term, I think the consensus estimates which push companies to provide guidance and shorter-term investors to continue to demand it, should be abolished. This may be a somewhat radical view, but the consensus estimates being generated by sell side analysts—some of whom are knowledgeable and others who may not be paying close attention—create expectations not necessarily set by the company. This causes volatility in shares when companies miss the analysts' estimates.

Investor relations at the board level is a perennial topic. Is it starting to happen?

Board-level investor relations is actually not new. It was always a factor in proxy contests. It became more common with director involvement in say-on-pay campaigns. In recent years, shareholder activism has elevated the board's role in investor relations to the point where it is no longer controversial for directors to meet and speak with investors.

Many attorneys see the merit of it and recommend it. Board-level IR still isn't typically organized systematically like the rest of the IR program unless it is supported and included as part of the outreach program. It often occurs when there is a special reason such as a request from a shareholder, rather than on a fixed schedule, although this is still evolving. Regular, periodic interactions are becoming more common.

Board involvement has affected my role leading investor relations programs in several ways. First, one of my responsibilities has been to keep the board of directors informed about who the owners are and what issues are of concern to them. Depending on the issues raised by shareholders, I would get the internal clearinghouse up and running to provide the information that management and the board need to formulate a response and determine how to respond. I would help create the message content and engagement materials, set up and attend the investor meetings with management and board members and then follow up to get feedback afterwards.

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What role does IR play when a company is targeted by an activist?

I have had direct experience with activist campaigns twice during my career. What I have learned is that activism is the ultimate test of effective investor relations because it galvanizes internal resources to respond to the issues raised by the activist. Each situation is unique and requires a thoughtful assessment and response that will produce the most effective course of action for the leadership team, the board of directors and the shareholders. The role IR plays in an activist campaign is to evaluate the situation, analyze the issues, gather the facts and work with the leadership team and the board to formulate appropriate responses that clearly and effectively communicate the company's position to investors.

I believe that at firms that have dealt with activism much of the internal adaptability and progressive elements of their IR programs grew out of management's deeper understanding of the strategic role IR can play when responding to complex activist challenges. The collaborative IR programs that I have run include many of these features—they are proactive, transparent and responsive. The best defense is a good offense. I think it would be fair to say that the Investor Relations information clearinghouse can be a model for companies that want to proactively take steps to strengthen both internal and external stakeholder relationships and avoid being targeted by activists.

Companies should know their vulnerabilities, address them and be prepared with a plan to address activism if it arises. That being said, a clear strategy and solid financial performance must be combined with an effective investor communications program to avoid being placed in a defensive position.

Companies should know their vulnerabilities, address them and be prepared with a plan to address activism if it arises.

Conclusion

The "them versus us" mentality that characterized relations between shareholders and public companies for decades is giving way to much more complex, individualized relationships. Globalization, governance standards, indexing, strategic activism, board accountability, stewardship codes, ESG and technology are among the factors that have changed the way companies and shareholders interact and relate to each other.

These developments substantially increase the challenges faced by public companies, but there is a positive impact as well: in today's environment individual companies have a better chance of being evaluated by investors on the merits rather than exclusively in terms of their compliance with external standards. This depends, of course, on two conditions—(*i*) companies must be willing to build sustained relationships with shareholders and improve the quality of the information they provide; and (*ii*) institutional investors must reconfigure their investment models to include ESG and non-financial metrics and they must focus on the long term.

Valerie Haertel's response to this changing environment has been to designate the Investor Relations Department as an "information clearinghouse." This approach worked well for the companies where she worked. Other solutions are also possible. Many companies have appointed dedicated corporate governance officers who work collaboratively with other corporate departments and with boards of directors. Proxy statements have morphed beyond traditional formats to include livelier and more informative presentations. Directors are emerging from the boardroom to meet, listen, and talk to shareholders. The corporate secretary's role is expanding to strengthen relations with institutional investors and guide director engagement campaigns. Companies have created new departments to deal with their environmental and social responsibilities.

Our experience at Morrow Sodali is that issuers increasingly recognize that managing their relations with shareholders and institutional investors is central to risk oversight and annual corporate planning. They are dedicating additional resources and time to the various tasks associated with the annual corporate governance cycle and taking steps to prevent activism from occurring rather than waiting until it happens and reacting defensively. Well-established disciplines such as market research and customer relationship management are serving as models for companies to deal effectively with these challenges through research, ownership profiling, market surveillance, board-level engagement and enhanced communications that "tell the company's story."

In the end, relations between issuers and institutional investors are a two-way street. Both sides must cooperate. The most important question still remains to be answered: Will institutional investors follow through on their commitment to: (*i*) evaluate companies individually; (*ii*) focus on long-term performance; and (*iii*) consider corporate purpose, ESG, and non-financial factors when they make their investment and proxy voting decisions?

THE UNEXPECTED IMPACT JUDGE KAVANAUGH'S APPOINTMENT TO THE SUPREME COURT COULD HAVE ON U.S. SECURITIES LAWS

By Adam S. Katz & Ryan W. McNagny

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After a lengthy and highly controversial confirmation process, Brett M. Kavanaugh, formerly a judge on the United States Court of Appeals for the District of Columbia Circuit, has replaced Anthony M. Kennedy as the newest justice on the Supreme Court of the United States. Kavanaugh's appointment has obvious significance, as conservatives now comprise the majority of the Supreme Court. Less obvious is the impact Kavanaugh's appointment will have on U.S. securities laws. Due to the timing of the nomination, Kavanaugh will face an important decision: whether to recuse himself from a securities fraud case he recently heard as a D.C. Circuit Court judge.

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The Case: *Lorenzo v. Securities and Exchange Commission*

Lorenzo v. Securities and Exchange Commission,[2] which the Supreme Court recently agreed to hear on appeal, involved an investment banker who, at the direction of his boss, copied and pasted fraudulent statements written by his boss into emails to two potential investors. The statements were intended to induce the investors to purchase bonds from Lorenzo's only investment banking client at the time, a startup energy company. Despite Lorenzo's knowledge that the company had recently declared its assets devoid of value, Lorenzo's emails informed the investors that the company had over $10 million in confirmed assets and $43 million in orders. However, Lorenzo's emails expressly indicated that he had sent them "at the request of" his boss. Lorenzo claimed that he simply copied and pasted the emails at his 'sboss' direction without any independent analysis of their contents.

In a split decision, the D.C. Circuit concluded that Lorenzo, by copying and disseminating his 'sboss' words to potential investors, was not the "maker" of the fraudulent statements for the purposes of Rule 10b-5(b) under the Securities Exchange Act of 1934, which deems it unlawful "[t]o make any untrue statement of a material fact. . . in connection with the purchase or sale of any security."[3] However, the court found that Lorenzo acted with the requisite intent in sending the emails and therefore was liable for participating in a "fraudulent scheme" under Rule 10b-5(a) and (c) and Section 17(a)(1) of the Securities Act of 1933, which deem it unlawful "to employ any device, scheme, or artifice to defraud. . . in connection with the purchase or sale of any security."[4]

In so holding, the court differentiated *Janus Capital Group, Inc. v. First Derivative Traders*,[5] in which the Supreme Court articulated the rule that the "maker" of a statement for purposes of Rule 10b-5 is the individual or entity with ultimate authority over its content. In *Janus*, the court found that an investment advisor who initially drafted false statements was not liable for violations of Rule 10b-5 where an independent entity disseminated the statements to investors in its own name because the investment advisor's role in preparing the statements was unknown to the investors. The D.C. Circuit found that, in contrast to the entity acting as an investment advisor in *Janus*, Lorenzo was significantly more culpable and acted as a participant in the scheme by sending the statements in his own name. The court emphasized that, "Unlike in *Janus*, therefore, the recipients of Lorenzo's emails were not exposed to the false information only through the intervening act of 'another person.' "[6]

Kavanaugh's Dissent

Kavanaugh dissented from the D.C. Circuit's opinion in *Lorenzo*, asserting that holding Lorenzo liable for "scheme liability" under Rule 10b-5(a) and (c) and Section 17(a)(1) blurred the line between primary liability and secondary liability (*i.e.*, aiding and abetting) for securities fraud violations. Instead, he stated that he would adopt the approach of other circuit courts that "scheme liability must be based on conduct that goes beyond a defendant's role in preparing mere misstatements or omissions made by others."[7]

In Kavanaugh's view, expanding the scope of scheme liability to hold individuals in Lorenzo's position liable for primary violations of Rule 10b-5 will effectively eliminate secondary liability by making aiders and abettors primarily liable for securities fraud violations.

In his view, this rule is intended to prevent those who would normally be only secondarily liable for aiding and abetting the making of fraudulent misstatements from being held primarily liable for the same conduct under a theory of scheme liability. In Kavanaugh's view, expanding the scope of scheme liability to hold individuals in Lorenzo's position liable for primary violations of Rule 10b-5 will effectively eliminate secondary liability by making aiders and abettors primarily liable for securities fraud violations.

The distinction between primary liability and secondary liability is particularly important to the SEC, because it is easier to prove primary liability. This is because, in order to prove secondary liability, the SEC must prove not only a securities violation by the primary violator, but also knowledge of this violation and "substantial assistance" by the aider and abettor in committing the violation. It is also particularly significant to private plaintiffs, who are not permitted to bring claims for aiding and abetting securities fraud.[8] For this reason, blurring the line between primary and secondary liability would make it much easier for the SEC and private plaintiffs to prove securities fraud claims against entities and individuals like Lorenzo, who did not "make" the fraudulent statement at issue.

The Potential Impact of Kavanaugh's Appointment

What do Judge Kavanaugh's dissent and appointment to the Supreme Court mean for the *Lorenzo* case? Due to his prior involvement in the case as a D.C. Circuit judge, Kavanaugh may be forced to recuse himself from the case, leaving the possibility of a split decision.[9] In fact, in 2016, public interest group Fix the Court found that Supreme Court justices recused themselves 180 times in a single session, with most of the recusals due to prior work on the case at issue.[10] For this reason, it is not only possible, but likely, that Kavanaugh will be forced to sit on the sidelines when the Supreme Court hears the *Lorenzo* appeal.

If Kavanaugh does recuse himself from the case, his recusal will leave only eight justices to decide *Lorenzo*, and one fewer justice who favors a more restrictive view of who can be considered the "maker" of a statement and held liable for violations of Rule 10b-5 under a theory of scheme liability. This is critical, because *Janus* was a 5-4 decision, with the four more liberal justices—Stephen Breyer, Ruth Bader Ginsburg, Sonia Sotomayor, and Elena Kagan, all of whom are still Supreme Court justices—dissenting. In their dissent, these justices expressed their disagreement with the majority's view that only those with "ultimate authority" over a statement can be considered the "maker." Thus, a recusal by Kavanaugh would create a significant likelihood that the Supreme Court would reach a 4-4 deadlock in *Lorenzo*.

If Kavanaugh does recuse himself from the case, his recusal will leave only eight justices to decide Lorenzo, and one fewer justice who favors a more restrictive view of who can be considered the "maker" of a statement and held liable for violations of Rule 10b-5 under a theory of scheme liability.

A 4-4 deadlock would not only delay further clarification from the Supreme Court on the standard articulated in *Janus* but would also leave intact the D.C. Circuit's ruling in *Lorenzo*. As a result of this deadlock, ultimately the SEC would have significantly expanded authority under the D.C. Circuit's ruling, allowing the SEC to sidestep the higher burden of proof for aiding and abetting claims and instead impose primary liability for violations of Rule 10b-5 on a defendant who was not the "maker" of a fraudulent statement using a theory of scheme liability. Perhaps most significantly, an affirmance of the D.C. Circuit's ruling would allow private plaintiffs to invoke scheme liability to bring claims against secondary violators like Lorenzo, who would otherwise be beyond the reach of private actions for violations of Rule 10b-5.

While it appears unlikely Kavanaugh will participate in the *Lorenzo* appeal given his previous involvement and the strong opinion he has already articulated in the case, his appointment to the Supreme Court could have broader implications for U.S. securities laws. Even if a deadlock does prevent the Supreme Court from overruling the D.C. Circuit's holding in *Lorenzo* for the time being, a predominantly conservative Supreme Court is ultimately likely to expand the ruling of *Janus* to prevent individuals and entities who did not "make" the fraudulent statement at issue from being held liable under a theory of scheme liability, thereby significantly curtailing the ability of both the SEC and private parties to bring claims for primary violations of Rule 10b-5.

ENDNOTES:

[1]This article originally appeared in the American Bar Association's Tort Trial & Insurance Practice Section (TIPS) Professional Liability Insurance Committee Summer 2018 Quarterly Newsletter. It is being republished here with permission.

[2]*Lorenzo v. Securities and Exchange Commission*, 872 F.3d 578, Fed. Sec. L. Rep. (CCH) P 99896 (D.C. Cir. 2017), cert. granted, 138 S. Ct. 2650 (2018).

[3]Federal Code of Regulations, 17 CFR 240.10b-5(b) (1951).

[4]Federal Code, 17 CFR 240.10b-5(a) (1951); 15 U.S. Code § 77q (2010).

[5]*Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 131 S. Ct. 2296, 180 L. Ed. 2d 166, Fed. Sec. L. Rep. (CCH) P 96327 (2011).

[6]*Lorenzo*, 872 F.3d at 591.

[7]*Id.* at 600.

[8]*Id.* at 590.

[9]*See* 28 U.S.C.A. § 455 (1990).

[10]Debra Cassens Weiss, *Supreme Court Justices Recused Themselves 180 Times in Most Recent Term*, ABA Journal (Jul. 12, 2016), http://www.abajournal.com/news/article/supreme_court_justices_recused_themselves_180_times_in_most_recent_term.

ON THE GROUND AT ACAMS IN LAS VEGAS: THE CDD RULE, HUMAN TRAFFICKING & THE VALUE OF PUBLIC/PRIVATE PARTNERSHIPS

By Gina Jurva

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LAS VEGAS—Given that the recent Association of Certified Anti-Money Laundering Specialists (ACAMS) 17th Annual Anti-Money Laundering & Financial Crime Conference was held in Las Vegas, perhaps now is an optimal time to regroup and reflect upon the compliance challenges faced by financial institutions. And where better to discuss beneficial ownership and customer due diligence rules than in a metropolis built in the 1940s on money from drugs, racketeering, and other ill-gotten gains.

Indeed, it has been almost six months since the Financial Crimes Enforcement Network (FinCEN) implemented the Customer Due Diligence (CDD) Rule.[1] So, what do we know? What don't we know? And where are we headed?

Word on the street at ACAMS is that financial institutions are continuing to grapple with the CDD rule, both in interpretation and implementation. To that end, the conference included a panel, *The CDD Final Rule: What We've Learned So Far*, that was moderated by Dan Stipano, a partner at Buckley Sandler. Panel participants included: Elena Hughes, executive director and deputy head of anti-money laundering (AML) for the Institutional Securities Group at Morgan Stanley; Michelle Neufeld, executive vice president and head of Compliance and Operational Risk FIG at Wells Fargo; Frederick Reynolds, managing director and global head of Financial Crime Legal at Barclays Bank; and Rebecca Schauer Robertson, executive vice president and director of AML Compliance at South State Bank.

Word on the street at ACAMS is that financial institutions are continuing to grapple with the CDD rule, both in interpretation and implementation.

Beneficial Ownership Rule Challenges

The CDD rule is not really *that* hard to understand on a superficial level. The purpose of the rule is to "improve financial transparency and prevent criminals and terrorists from misusing companies to disguise their illicit activities and launder their ill-gotten gains," according to FinCEN.[2] "On its face, it is deceptively easy," Stipano said. "The challenges come in when implementing the rule and operationalizing it, and also when the examiners come in and examine for compliance."

We know that beneficial ownership is defined in dual parts—*i*) someone who has an 25% or greater equity interest; and *ii*) a person who controls that legal entity. As FinCEN later clarified in their "Frequently Asked Questions," that 25% threshold is a floor, not a ceiling, meaning financial institutions can lower the threshold to even a 10% controlling interest.

The panelists uniformly agreed that they are currently using 25% as the entry point but will use a lower threshold in certain circumstances. "How do you convey that lower threshold to a client?" Morgan Stanley's Hughes asked. "You may want to consider building in some flexibility on your threshold, particularly when we are talking about syndicated loans."

There are also times where certain events may trigger going lower than 25%. "We generally stick to 25% but will go deeper if necessary if there are indicators out there such as negative news," Reynolds of Barclays Bank said. Interestingly, this question was also posed to the audience. Among audience members completing the polling question, 69% said they were sticking to the 25% floor as a guiding principle.

Complex Levels of Ownership Continue to be a Challenge

The beneficial ownership rule allows a bank to rely on their customers' representations regarding levels of ownership. Yet, the veracity of such information looms over the process. Can you trust your customers to provide accurate information? "You have to trust your customer, even if it is hard sometimes," explained Robertson of South Street Bank. "That is unless there is something that causes you to pause."

The other side of that coin, Reynolds stressed, is that if you do see something unusual, you have the ability to investigate further.

Jim Richards, founder of RegTech Consulting, and former Bank Secrecy Act (BSA) Officer and Global Head of Financial Crimes at Well Fargo & Co., agreed there are still several challenges related to the CDD Rule. "There are two implementation issues: One, what to do when the customer won't provide complete beneficial ownership information (usually the social security number of one of the owners); and two, how to use that info for monitoring and surveillance purposes," Richards said.

Despite the challenges, Richards remains optimistic. "It's early days," he said. "It will take some months or even years for audits and exams to flesh out these issues."

Key Takeaways

Institutions continue to evolve and grow as they outline practical methods to address unique CDD Rule challenges, such as specialized staff training and managing triggering events.

A few other takeaways from the panel included:

- There are still lots of gray areas that institutions are working through. If your financial institution is working through these issues, you are not alone.
- Staff training continues to be an on-going process.
- Be proactive in documenting your processes.
- When in doubt, consult with the examiners about both compliance process and procedure.
- Financial institutions should continue to update, onboard, and training of staff at all lines of defense.

Human Trafficking in the Illicit Massage Business

Another topic of great interest discussed at the ACAMS conference involved the scourge of human trafficking. A conference panel comprised of individuals from law enforcement, the non-profit Polaris Project, the financial sector, and Thomson Reuters Special Services (TRSS), discussed commercial sex trafficking in the United States and ways to disrupt it. The panel, *Crafting Detection and Investigation Systems to Fight Human Trafficking*, was moderated by Michael Greenman, Senior VP and Chief Counsel of Financial Crimes Legal at US Bank; and included panelists Marcy Forman, Managing Director for the Global Investigations Unit, AML Compliance, for Citigroup; Rochelle Keyhan, Director of Disruption Strategies at Polaris; John F. Tobon, Deputy Special Agent in Charge, Homeland Security Investigations (South Florida); and Peter Vincent, General Counsel of Thomson Reuters Special Services and Assistant Director General International Policy for BORDERPOL.

Let's say you are walking down the street in the trendy *DTLA*, (*a.k.a.* downtown Los Angeles) and feeling a bit tense after a long day at work. So, you think to yourself, "I could really go for a Swedish massage." You begin scrolling through Yelp when suddenly you look up from your mobile device and spot a sign in a window fortuitously calling out to you, "Panda Massage, $20/hr." You've had a lot of massages in your life, but something tells you that the below market rate of $20 an hour won't get you the legitimate, therapeutic benefits you had in mind.

In fact, you may have just stumbled upon an illegal sex business. Illicit massage parlors are one of several types of businesses that human traffickers use to make a profit. Those profits are all part of a money-laundering scheme where monies flow back to the criminal enterprise in a never-ending cycle; never-ending unless we do something to disrupt the criminals.

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Illicit Massage Parlors

The illicit massage industry is big business for sex traffickers. According to statistics from Polaris, massage parlors generate more than $2.5 billion in annual profits—profits made because of human bondage.[3] "There are over 9,000 illicit massage parlors currently open for business in the U.S" said Polaris' Keyhan, pointing out that the principal indicators that a business is selling commercial sex and is a possible human trafficking venue include:

- Prices for massages significantly below market;
- Serves primarily or only male clientele, and is open 24 hours a day;
- Locked front door, customers can only enter if buzzed in or through discreet back or side doors;
- Covered or blacked out windows; and
- Women appear to be living in the establishment.

Working with Law Enforcement: Public-Private Partnerships

There are concrete steps financial institutions take to effectively identify and disrupt human trafficking. Forman from Citigroup outlined both internal steps that institutions can take—such as focusing on business sectors that are more vulnerable to abuse (night clubs, spas, and employment agencies) and educating first-line personnel and staff about what she described as "face-to-face" indicators—to more external steps, including partnering with law enforcement and NGOs to obtain information about human trafficking and utilizing the USA PATRIOT Act where appropriate.[4]

Human trafficking investigations can be challenging and labor intensive, the panel said. Identifying victims is one of the top issues surrounding these investigations, simply by the covert nature of the business.

According to the 2017 Federal Human Trafficking Report,[5] the notorious sex advertising website Backpage.com was the primary method of purchaser solicitation, noting that out of 458 active criminal sex trafficking cases, 331 or 72.3 % involved advertisements on the website. Backpage.com was shut down by federal law enforcement in April 2018.[6]

TRSS' Vincent noted that when Backpage.com was shut down, it actually removed an investigative tool from law enforcement's arsenal. "Shutting down Backpage.com, although righteous, effectively removed a critically important investigative platform that was heavily leveraged by law enforcement," Vincent from TRSS stated.

Yet, Backpage.com is not the only online platform used to facilitate commercial sex transactions in sex trafficking cases. Internet-based commercial sex cases also involved the use of Facebook, Craiglist, MyRedBook, Instagram, KiK Messenger, Tagged, Eros, Adult Friend Finder, Pinger, Executive Companion, and several others, according to the report.

Financial Institutions Key Takeaways

The issue of human trafficking in the massage sector and other businesses is complicated beyond what a one-hour ACAMS panel or blog post can solve. Yet, there are some key takeaways for financial institutions that panelists outlined, including:

- Devise methodologies for data-mining transactions and customer information for potential indicators;
- Utilize the USA PATRIOT Act for information sharing (when lawful) and always *follow the money*;
- Work with internal legal resources to share information and findings though industry forums and outreach (when appropriate); and
- Partner with law enforcement.

Results Unveiled: Thomson Reuters/ ACAMS Anti-Money Laundering Regulatory Survey

On the final day of the conference, the annual Thomson Reuters/ACAMS AML Regulatory survey[7] was released, showing that among the top regulatory challenges for financial institutions is the CDD Rule and Enhanced Due Diligence (EDD), while issues like virtual currencies and the Bank Secrecy Act (BSA) are increasingly on the minds of compliance officers.

What did the survey show? Financial organizations are spending more resources and time addressing new requirement and adding staff and enhanced technologies as the result of shifting regulatory compliance requirements.

All of this is happening, with the FinCEN's CDD Rule looming in the background. It is not a rule to be ignored and it is one that financial institutions are taking seriously. The new survey focuses on compliance trends in the financial sector. Three months after the implementation of the CDD Rule in May, Thomson Reuters partnered with ACAMS to learn what AML industry leaders were thinking. The survey relates to compliance processes and activities in response to regulations and associated CDD and Know Your Customer (KYC) requirements.

More than 250 respondents who are considered "decision-makers" in their organizations related to AML and CDD compliance activities answered the survey. These are individuals who live and breathe these processes, challenges, and victories on a daily basis.

Survey Objectives

The survey participants, drawn from ACAMS members, answered questions related to a broad range of measures to track trends among companies in the financial sector, including:

- CDD and AML processes;

- Ultimate Beneficial Ownership (UBO) compliance;
- EDD;
- Data solutions;
- Budget and staffing; and
- Challenges and trends.

Key Takeaways

Not surprisingly, 54% of organizations reported training for existing staff is one of their highest priorities for their AML and CDD compliance program over the next 12 months. That is an astounding a 10% jump from 2017. "Investing in staff training to manage workloads and build expertise among current staff, as well as hiring additional staff to fill the growing AML investigation needs to keep up with CDD Rule compliance" is a key area of respondents' focus, according to the survey.

A few other takeaways from the survey include:

- Organizations have fine-tuned their typologies for alerts around CDD issues;
- Organizations are striving to improve their response time to red flags with an eye toward addressing potential fraud and money laundering;
- Regulatory enforcements seem to be a less common occurrence;
- Personal civil and criminal liability concerns continue to grow, with 28% of respondents saying it is on their minds, particularly in light of the so-called "Yates Memorandum";[8] and
- Top areas of interest, in addition to the CDD rule are CDD and UBO regulatory changes, as well as concerns over virtual currency, cryptocurrency, and blockchain, and the Fourth EU AML directive.[9]

ENDNOTES:

[1]For more on the CDD Rule, *see* http://www.legalexecutiveinstitute.com/ubo-rule-compliance-checklist.

[2]*See* https://www.fincen.gov/news/news-releases/fincen-reminds-financial-institutions-cdd-rule-becomes-effective-today.

[3]*See* the Polaris Project statistics, *available at* https://polarisproject.org/massage-parlor-trafficking.

[4]The USA PATRIOT Act, https://www.justice.gov/archive/ll/highlights.htm.

[5]*See* 2017 Federal Human Trafficking Report, *available at* https://www.traffickingmatters.com/wp-content/uploads/2018/05/2017-Federal-Human-Trafficking-Report_hi-res.pdf.

[6]Reuters News, "Sex ads website Backpage shut down by U.S. authorities," April 6, 2018; *available at* https://www.reuters.com/article/us-usa-backpage-justice/sex-ads-website-backpage-shut-down-by-u-s-authorities-idUSKCN1HD2QP.

[7]The Thomson Reuters/ACAMS AML Regulatory survey is available for free download here: https://tmsnrt.rs/2S4WB3i.

[8]Department of Justice memorandum, "Individual Accountability for Corporate Wrongdoing" by Deputy Attorney General Sally Yates, (Yates Memorandum), Sept. 9, 2015; *available at* https://www.justice.gov/archives/dag/file/769036/download.

[9]European Union Fourth Anti-Money Laundering Directive; ACAMS, *available at* https://www.acams.org/aml-resources/eu-fourth-aml-directive.

EFFECTIVE COMPLIANCE & AVOIDING THE NEED FOR CORPORATE MONITORS: DOJ ASS'T AG BENCZKOWSKI OFFERS GUIDANCE ON NEW POLICY

A Speech by DOJ Ass't AG Brian A. Benczkowski

Brian A. Benczkowski, Assistant Attorney General for the Criminal Division in the U.S. Department of Justice (DOJ), spoke about the Department's new approach to evaluating company compliance and the imposition of corporate monitors at the NYU School of Law Program on Corporate Compliance and Enforcement Conference on October 12 in New York City. This is a partial transcript of his comments.

[. . .] Consistent with the themes of this event, and the Department's ongoing work to update, refine and clarify our corporate enforcement policies, I intend to focus my remarks today on the Criminal Division's approach to corporate compliance and monitorships.

[. . .] During my last tour at the Department, I was privileged to work closely with then-Deputy Attorney General Mark Filip as we drafted the Department's Principles of Federal Prosecution of Business Organizations, which many practitioners colloquially refer to as the "Filip Factors." When we were drafting the Principles a decade ago, we made a conscious decision to break from the prior practice of issuing policy by memorandum and instead placed the Principles in what was until recently called the United States Attorney's Manual. That guidance has endured and continues to define the primary factors applied to corporate enforcement cases across the Department.

After leaving the Department, I was fortunate to work in private practice for more than eight years at a well-known global law firm. There, I represented clients in corporate enforcement matters before the Department, and often advised companies on their compliance programs and how best to navigate operations while under the oversight of corporate monitors. My experiences on both sides of corporate enforcement formed the root of my understanding and perspective of the complex compliance issues that companies must navigate each and every day.

Now that I have returned to the Department, I have the duty to oversee some of the most significant corporate enforcement cases across the country.

Among the sections within the Criminal Division that handle these cases are the Fraud Section, headed by Acting Chief Sandra Moser, and the Money Laundering and Asset Recovery Section (MLARS), headed by Chief Deb Connor. [. . .] While these cases involve many different industries and fact patterns, one constant is that every case will at some stage require a deep look into the sufficiency and proper functioning of the subject company's compliance program. As companies continue to grow in size, scope and complexity, and as international business becomes the norm rather than the exception, compliance is of ever greater importance in ensuring that companies operate efficiently and within the bounds of the law.

As many of our corporate enforcement policies make abundantly clear. . . compliance is an important factor we take into consideration in every corporate enforcement matter we review. In these cases, our prosecutors assess the compliance function both at the time of the conduct and at the time of resolution in order to reach a fair and appropriate resolution in cases involving corporate wrongdoing. As a result, our prosecutors and supervisors must have a strong foundational understanding of what constitutes an effective approach to compliance.

Previously, the Criminal Division attempted to address the need for this expertise by hiring a single compliance counsel who was housed in the Fraud Section. While this approach had its benefits, there are inherent limitations in having the locus of our compliance expertise consolidated in a single person in a single litigating section.

Even when fully briefed on a matter, a single compliance professional who has not been involved in a case throughout an investigation is not likely to have the same depth of factual knowledge as the attorneys who make up the case team. Nor can any one person be a true compliance expert in every industry we encounter. An effective, state of the art compliance program in the banking industry, for example, is going to look very different from one in the health care, energy, or casino industries.

Even when fully briefed on a matter, a single compliance professional who has not been involved in a case throughout an investigation is not likely to have the same depth of factual knowledge as the attorneys who make up the case team.

Relying on a single person as the repository of all of our compliance expertise also is shortsighted from a management perspective. Anyone who holds such a job will inevitably and quickly feel a strong pull to the private sector. Their expertise is simply too valuable in this day and age. If and when that person departed, we would have to start from scratch and find a replacement. And that process undoubtedly would repeat itself every few years, with little long-term benefit to the Criminal Division. That is the position we find ourselves in right now.

Now, to be clear, I'm not suggesting that all or even most of our trial attorneys and supervisors lack compliance knowledge and experience. Indeed, it is just the opposite.

Our last compliance counsel spent considerable time training our attorneys and developing in-house knowledge and expertise among attorneys in the Division. That work was very beneficial.

Going forward, I intend to build upon this capacity and knowledge across every section in the Division that requires it, starting with Fraud and MLARS, where the bulk of our corporate enforcement activity takes place. We will accomplish this through a combination of diverse hiring and the development of targeted training programs.

When hiring in the Criminal Division, we will focus on building a team of attorneys who offer diverse skillsets. That means not just attorneys with experience as prosecutors and in the courtroom, but also those who bring compliance experience to the table.

In the context of corporate enforcement, having a trial attorney with experience litigating corporate cases paired with an attorney who has experience developing and testing corporate compliance programs allows us to leverage our talent, which should lead to better and more just outcomes.

In the context of corporate enforcement, having a trial attorney with experience litigating corporate cases paired with an attorney who has experience developing and testing corporate compliance programs allows us to leverage our talent, which should lead to better and more just outcomes.

Consistent with the Principles of Federal Prosecution of Business Organizations, our trial attorneys and supervisors must address a number of factors in each and every case as they weigh an appropriate resolution. It only makes sense to have the same attorneys evaluating all of those factors together. I believe our prosecutors should consider the adequacy of a compliance program at the same time they are considering, for example, a company's remedial actions or the timeliness of any voluntary self-disclosure. It makes little practical sense to outsource a separate review of the compliance program when considering the merits of a corporate matter. Instead, all of the Filip Factors should be weighed by the entire case team as part of a single, comprehensive review and determination of the right outcome.

As we move towards a workforce better steeped in compliance issues across the board, we also will need to increase training in this area.

The Department has been training attorneys how to investigate and try cases for decades. We do so for attorneys who are right out of law school and entering our Honors program, for attorneys coming off clerkships, and for attorneys that have spent the bulk of their careers in private practice. This training is accomplished in a variety of ways.

We send new hires to our National Advocacy Center for intensive trial advocacy training. And we assign new attorneys as junior members of trial teams to build experience in the courtroom. In our United States Attorney's Offices (USAOs), new prosecutors often start their careers carrying a busy misdemeanor docket or working less complex felony cases. In the Criminal Division, we often detail new attorneys to USAOs to gain this same experience. And we offer a broad array of both voluntary and mandatory training to all of our attorneys across the Department.

This in many ways tracks my experience in private practice. When law firms bring in new associates or more senior attorneys who lack significant experience in certain areas, firms often provide extensive training programs and pair these attorneys with more experienced practitioners from whom they can learn. In some instances, firms second young attorneys to clients to gain this valuable experience.

Our expectation is that the Division will develop a training program that addresses compliance programs generally, as well as issues specific to each section and unit. As a result, more of our health care fraud attorneys who work on corporate cases will become experts in health care industry compliance; attorneys working on securities and commodities cases will become experts in compliance relating to securities laws and trading. We will take this same approach for attorneys who work on Foreign Corrupt Practices Act (FCPA) cases, or MLARS attorneys who do cases involving the banking industry. Ultimately, our goals are to ensure a balance of experience across the Division and to enhance the expertise of our trial attorney workforce.

We want to ensure that we build and maintain the capacity we need not just for today or next year, but for 10 years down the road. And it will lessen the impact when people inevitably leave the Department to retire or follow other career paths.

Our renewed approach to compliance training makes good management sense, but also should be a plus for companies and defense attorneys that find themselves across the table from us. When negotiating a corporate resolution, we want to ensure that our attorneys can successfully navigate the difficult compliance and other issues that arise during these discussions, including whether the facts and circumstances of a particular case warrant the imposition of a corporate monitor.

I know from personal experience that the issue of whether a monitor will be required is one of the most significant aspects of any corporate resolution. When the Criminal Division decides to impose a monitor, I believe we have an obligation to ensure that we have done so for the right reasons. We also have a continuing obligation to interact with the monitor and address any problems that may arise during the course of the monitorship.

I know from personal experience that the issue of whether a monitor will be required is one of the most significant aspects of any corporate resolution.

Let me be clear, I think our attorneys have performed quite admirably in this area. But I also recognize that there is always room for improvement in our policies and procedures to ensure we are acting responsibly when we impose this significant, but often times necessary burden on a corporation.

Last year, Deputy Attorney General Rod Rosenstein spoke at another PCCE event and proclaimed that the Department would be actively reviewing a wide range of existing corporate enforcement policies. Consistent with this directive, we have been reviewing our monitorship policies and procedures since my arrival.

As a result of that review, I'm pleased to announce that yesterday I issued new guidance relating to the imposition and selection of corporate monitors in Criminal Division matters. The new policy memorandum, as well as my prepared remarks for today, will be made available on the Criminal Division's website. The goal of the new guidance is to further refine the factors that go into the determination of whether a monitor is needed, as well as clarify and refine the monitor selection process.

Importantly, the new policy supersedes the guidance contained in the 2009 Breuer Memorandum regarding the selection of corporate monitors, but it does not replace prior guidance contained in the memorandum issued in 2008 by then Acting Deputy Attorney General Craig S. Morford. Rather, the new policy supplements the *Morford Memo*.

As an initial matter, while the Morford Memorandum applied by its terms only to deferred prosecution and non-prosecution agreements, our new memorandum makes clear that the Criminal Division also will apply the same principles to court-approved plea agreements that impose a monitor.

Our approach to the new policy began with the foundational principle that the imposition of a corporate monitor is never meant to be punitive. It should occur only as necessary to ensure compliance with the terms of a corporate resolution and to prevent future misconduct. That approach is consistent with our longstanding practice of imposing corporate monitors as the exception, not the rule. I recently reviewed statistics for the Fraud Section, and over the past five years or so, approximately one in three corporate resolutions involved the imposition of a corporate monitor. So, the overwhelming majority of our resolutions do not involve a monitor.

Our approach to the new policy began with the foundational principle that the imposition of a corporate monitor is never meant to be punitive.

Our new policy explicitly recognizes that, "the imposition of a monitor will not be necessary in many corporate criminal resolutions, and the scope of any monitorship should be appropriately tailored to address the specific issues and concerns that created the need for the monitor."

In making their determination, Criminal Division attorneys must consider a number of factors, including the type of misconduct—such as whether it involved the manipulation of books and records or the exploitation of inadequate internal controls and compliance programs. Attorneys also will assess the pervasiveness of the conduct and whether it involved senior management. Other factors consider any investments and improvements a company has made to its corporate compliance program and internal control systems, and whether remedial measures have been tested for the ability to prevent or detect similar misconduct in the future. Similarly, the policy takes into consideration whether the misconduct took place in an inadequate compliance environment that no longer exists. Notably, the new policy also considers whether misconduct took place under different corporate leadership, and it recognizes the unique risks and compliance challenges of the particular region and industry in which a company operates.

Finally, in terms of whether a monitor is necessary, the policy directs Criminal Division attorneys to also consider both the financial costs to a company, as well as unnecessary burdens to the business's operations.

We believe this pragmatic approach to monitorships will ensure that we continue to carefully evaluate each case, based on specific facts and after a careful assessment of a company's corporate compliance program at the time of resolution. This means not only determining whether the program is adequate on its face, but also how its effectiveness has and will continue to be tested.

The policy also addresses the selection process for corporate monitors.

I'm not going to get into all the details, but our goal here is to ensure that the process is fair, ensures the selection of the best candidate, and avoids even the perception of any conflicts of interest. For this reason, the Division's monitor selection committee will continue to include an ethics official from the Criminal Division. We want to ensure that businesses and the public are confident in the selection process, avoiding any suggestion that monitors are chosen for inappropriate reasons, including personal relationships or past employment in the Department.

Finally, the policy recognizes that there may be unique circumstances that require a departure from the procedures contained in the policy. This may occur when working a case jointly with a USAO that may have different policies and procedures, in which case the policy provides for some flexibility, with any departures from the policy subject to certain approvals by Criminal Division leadership.

Ultimately, a monitor should benefit the company, its employees, shareholders, and the public by effectively furthering the goal of preventing and detecting future misconduct.

Ultimately, a monitor should benefit the company, its employees, shareholders, and the public by effectively furthering the goal of preventing and detecting future misconduct.

As I wrap up, I'd like to take a few moments to address the Department's obligations after imposing a monitor. I want to make very clear that once a monitor is selected and installed, our work at the Department is far from over. We take seriously our burden of ensuring that monitorships are being carried out properly and effectively. In particular, it is incumbent on our prosecutors to ensure that monitors are operating within the appropriate scope of their mandate. Monitorships should never be expanded or extended for any illegitimate reason.

While the contractual agreement is ultimately between a monitor and the company, we are here to act as a referee of sorts where needed, consistent with the governing agreement. If a company that is subject to a monitor encounters problems, they should feel comfortable approaching the Department. While we do not want to encourage frivolous claims, we absolutely want to know of any legitimate concerns regarding the authorized scope of the monitorship, cost or team size. If a company wants to raise its hand with an issue, we are here to listen.

We also are committed to meeting regularly to assess the appropriateness of a monitor's recommendations, including whether the company appears on track to complete the implementation of recommendations.

SEC STATEMENT ON MARKET DATA FEES AND MARKET STRUCTURE

From SEC Chairman Jay Clayton

On October 16, Securities and Exchange Commission Chairman Jay Clayton issued a statement regarding the SEC's recent action on a challenge to rule changes of two national securities exchanges. The following is a partial transcript of that statement.

Today, the Commission took two actions with respect to the regulation of market data fees—*i.e.*, the fees our regulated exchanges charge market participants for market data.[1] These matters involve issues of law and fact, and by their very nature—challenges to fee amounts—are contentious. Fee disputes of this type also can be complex, including because today's trading activity is itself complex and data driven.

Below, I summarize these two actions with an eye toward informing our Main Street investors about market data fees and market structure more generally. Please recognize that summaries of complex matters have limitations and that my summary is my own (not the views of the Commission, my fellow Commissioners or the SEC Staff), and my discussion of the Commission's orders is qualified by reference to these orders.[2]

Summary of Today's Two Actions

In the first action, the Commission issued a decision in a challenge to rule changes of two national securities exchanges, NYSE Arca, Inc. and Nasdaq Stock Market LLC, concerning certain market data fees (the "Data Fee Decision"). The Commission set aside the challenged fees, finding that the exchanges had not met their statutory obligation to demonstrate that the fees were consistent with the Exchange Act (*i.e.*, that these fees are fair and reasonable and not unreasonably discriminatory). To be clear, the Commission's decision does not mean the fees were too high, rather it means that the exchanges have not provided sufficient factual and legal support to continue to charge those fees. This matter was commenced in 2013, and fees of the type at issue in the challenge have been the subject of various Commission and court proceedings over the last decade.

During the pendency of the action that resulted in the Data Fee Decision, more than 400 other challenges to market data and market access fees were filed with the Commission. In today's second action, the Commission issued an order "remanding" these challenges. In other words, the Commission sent the actions back to the exchanges for further review and, if appropriate, resubmission to the Commission.

Our Trading Markets and Market Data

Our trading markets have changed substantially in the past two decades and are far different from the markets of a generation ago. Today's markets are dominated by electronic trading and sophisticated technologies. In most cases, offers to purchase and sell are generated by computer programs or "algorithms." A portion of these offers to sell or purchase are matched, often instantaneously by other computers, resulting in completed trades. The purchase and sale orders of Main Street investors and other market participants—for example, a request to buy 100 shares of XYZ Corporation—are fed into this largely electronic trading ecosystem.

This "electronification" of our markets has brought significant efficiencies and other enhancements. It also has raised new regulatory issues and other questions. One issue is the increased importance of timely and robust "market data." The computer algorithms that generate purchase and sale orders and determine where to route such orders depend on market data. Most market data, including detailed data concerning trading interests generated by trading participants at exchanges, is available for purchase. Accessing this market data, and in many cases accessing this data very quickly (*i.e.*, in "microseconds" or "nanoseconds"), is integral to a variety of computer trading algorithms and market activity today.

This "electronification" of our markets has brought significant efficiencies and other enhancements. It also has raised new regulatory issues and other questions.

The SEC regulates exchanges' sale of this type of market data. More specifically, but speaking generally about the applicable regulations, exchanges are permitted to set fees for this market data, but market participants are permitted to challenge those fees. Today's first action is a result of such a challenge.

It is with this history and current context that I support both actions taken today and believe that they are in the best interests of our markets and our Main Street investors. As described in detail in the Commission's 54-page Data Fee Decision, two exchanges did not meet their statutory burden. As a result, the Commission set aside the fees from the date of the order forward.

It is worth emphasizing again that the Commission did not conclude that the fees are unfair or unreasonable. Instead, we found that the facts and theories put forward by the exchanges did not sufficiently demonstrate that the fees satisfied the relevant statutory test. It also is worth emphasizing that the Commission action setting aside the challenged fees is forward looking or "prospective."

The second action today—the Commission's remand order concerning the other approximately 400 challenges—does not invalidate the other challenged fees, nor does it express a view on the merits of these challenges. In practical terms, the remand order gives the exchanges and market participants an opportunity to step back and review those disputes in light of today's Data Fee Decision and other market and regulatory developments and other factors.

Looking Forward

The matters addressed in today's orders have been before the Commission for a substantial period of time. I believe that as we move forward, today's actions will enable the Commission and market participants to more efficiently and effectively ensure that market data fees are set, reviewed and regulated in the best interest of our markets and our Main Street investors. More generally, I believe these actions, taken together with other initiatives of the Commission and our dedicated staff, will improve our regulation of market structure as it exists today and will inevitably continue to evolve.

In that regard, next week, our Division of Trading and Markets will host a public roundtable on market data and market access issues.[3] I look forward to an insightful and constructive discussion at the roundtable, reflective of a broad and diverse representation of panelist perspectives. The roundtable will be an important step in what will be a broad and open-minded review of our regulatory approach in this area.

Our focus on market structure issues will, as always, start and end with ensuring that our markets meet the needs and serve the interests of our long-term Main Street investors.

ENDNOTES:

[1]*In the Matter of the Application of Securities Industry and Financial Markets Association*, Exchange Act Release No. 84432 (Oct. 16. 2018), *available at* https://www.sec.gov/litigation/opinions/2018/34-84432.pdf; *In the Matter of the Applications of the Securities Industry and Financial Markets Association and Bloomberg L.P.*, Exchange Act Release No. 84433 (Oct. 16. 2018), *available at* https://www.sec.gov/litigation/opinions/2018/34-84433.pdf.

[2]The sole purpose of this statement is to provide our Main Street investors with background information and context about today's Commission actions, market data fees, and market structure more generally. This statement is not intended to have any binding legal or regulatory effect, nor is it intended to be a formal or official interpretation of today's Commission actions. Further, this statement does not alter today's Data Fee Decision (as defined) or remand order—each of which stands on its own.

[3]See "SEC Staff to Host Roundtable on Market Data and Market Access," SEC Press Release (Sept. 24, 2018), available at https://www.sec.gov/news/press-release/2018-210. The roundtable will be open to the public. Additionally, a live (and then archived) webcast of the roundtable will also be available on the SEC website.

FROM THE EDITORS

The Strange Case of Elon Musk, the SEC, and the Settlement that Almost Wasn't

Before Tesla Inc. and its founder Elon Musk agreed at the end of September to pay $20 million each as part of their settlement with the Securities and Exchange Commission over Musk's controversial comments on Twitter about taking the company private, the real battle occurred over Musk's role at the company *post*-settlement.

Apparently, Musk did not wish to relinquish his titles as CEO and Chairman of the innovative automaker, and the contentious negotiations were almost scuttled at several points because of this instance. In the end, the billionaire entrepreneur agreed to step down as the company's chairman but remain as chief executive, ending a tumultuous two months for the carmaker, its investors, Musk, and by extension, the SEC.

"The prompt resolution of this matter on the agreed terms is in the best interests of our markets and our investors, including the shareholders of Tesla," SEC Chairman Jay Clayton said in a statement. Under terms of the deal, Tesla must appoint an independent chairman, two independent directors, and a board committee to set controls over Musk's communications.

The SEC had charged the 47-year-old Musk with misleading investors with a series of tweets sent on August 7 that said he was considering taking Tesla private at $420 a share and that he had already secured funding. The SEC contended that the tweets had no basis in fact, and the ensuring market chaos had hurt investors. Indeed, Tesla and its investors were already growing concerned over Musk's behavior over the past several months, which included smoking marijuana and wielding a sword on a webcast and attacking a British rescue diver, also via Twitter.

Investors were said to be pleased with the SEC settlement because it resolved the matter quickly and left Musk—who is synonymous with the electric car company—at the helm of Tesla. "I think this is the best possible outcome for everyone involved" said Ivan Feinseth of Tigress Financial Partners, adding the SEC's penalty was "a slap on the wrist" for Musk. "The fact that he can remain CEO is very important for the company."

The SEC charged Tesla with failing to have required disclosure controls and procedures for Musk's tweets. The SEC said the company had no way to determine if his tweets contained information that must be disclosed in corporate filings, or if they contained complete and accurate information.

Earlier in the negotiations with the SEC, Musk walked away at the last minute from an earlier settlement that would have required him to give up key leadership roles at the company for two years and pay a nominal fine. At the time, Musk indicated he was willing to go to court over the matter.

The events with Musk and Tesla underscore how social media has become a more accepted platform for releasing news and making comments, especially from iconic company executives (or national politicians). And for the SEC, the popularity of Twitter may provide another wild frontier that the agency will now have to police.

—Gregg Wirth, Managing Editor

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