Congressional Research Service
Informing the legislative debate since 1914

Capital Markets: Overview and Selected Policy Issues in the 118th Congress

Updated March 9, 2023

Congressional Research Service
https://crsreports.congress.gov
R47431

CRS REPORT
Prepared for Members and
Committees of Congress

Congressional Research Service
Informing the legislative debate since 1914

Capital Markets: Overview and Selected Policy Issues in the 118th Congress

R47431

March 9, 2023

Eva Su, Coordinator
Analyst in Financial Economics

Gary Shorter
Specialist in Financial Economics

Jay B. Sykes
Legislative Attorney

Rena S. Miller
Specialist in Financial Economics

John J. Topoleski
Specialist in Income Security

SUMMARY

Capital markets are part of the financial system where entities raise funding from investors by dealing in stocks, bonds, digital asset securities, and other investments. As a main segment of the financial system, capital markets provide the largest sources of financing for U.S. nonfinancial companies. Securities issuers, intermediaries, and investors are all active participants in capital markets. The U.S. capital markets measure over $100 trillion in size, composed of about $52 trillion in equity and $49 trillion in fixed income as of 2021. Market participants include about 7,400 reporting companies, 4,000 publicly traded companies, 28,000 registered entities, 24 national securities exchanges, nine credit rating agencies, and seven active registered clearing agencies. The Securities and Exchange Commission (SEC) is the primary regulator overseeing capital markets. Capital market operations and regulation can be organized into several main components, including

Securities offerings. Over the past decade, companies have raised more funds through private securities offerings than through public offerings such as initial public offerings (IPOs). Policymakers are concerned about market transparency and equal access to investment opportunities in private securities markets.

Securities trading and market structure. Several developments in trading markets have also attracted the attention of policymakers. The SEC has scrutinized potential conflicts of interest, market competition, and market transparency issues raised by "payment for order flow," a practice whereby market makers pay brokers for the ability to execute retail client stock trades. Policymakers are also analyzing disruptions in the market for U.S. Treasury securities and evaluating options for enhancing market resilience.

Investment management. Some policymakers are concerned about financial stability risks in the investment management industry, including the perceived structural vulnerabilities surrounding money market mutual funds. Policymakers are also concerned about several issues involving private funds, including transparency, investor access, investor protection, and stakeholder perspectives.

Investment advisory services. Retail investors commonly use investment advisory services to help them meet their investment goals. As a result, they can be harmed when persons who provide such services face conflicts of interest. To address these concerns, the SEC and Department of Labor have established standards of care for broker-dealers, investment firms, and retirement accounts.

Environmental, social, and governance (ESG) investing. Investors have shown increasing interest in companies and funds that focus on ESG standards. The SEC has pursued related issues through proposed rules regarding climate disclosures by operating company issuers and the naming and disclosure requirements for certain investment companies.

Digital assets. The regulation of digital assets continues to occupy the attention of legislators, regulators, and the public. While the SEC has used its existing authorities to combat fraud and unregistered securities offerings involving digital assets, some commentators have highlighted gaps in the regulatory framework for digital assets that do not qualify as securities.

Capital markets volatility and market-driven events. Market volatility could warrant policy attention when it reveals structural vulnerabilities. During such episodes, Congress and the SEC have implemented several measures to ease extreme market conditions.

SEC agency operations and rulemaking. In 2021, Gary Gensler was confirmed as chair of the SEC. Since assuming office, Chair Gensler has pursued dozens of rulemakings. Some policymakers have raised concerns regarding the pace of the SEC's rulemaking and whether the agency has provided sufficient time for stakeholders to comment on key changes.

Contents

Introduction 1
Background 2
Market Composition and Key Players 2
Fundamental Concepts 3
Regulatory Architecture 4
Policy Issues by Market and Regulatory Components 5
Securities Offerings 6
Policy Issue: Growth of Private Securities Markets 6
Policy Issue: Special Purpose Acquisition Companies (SPACs) 8
Securities Trading and Market Structure 11
Policy Issue: Payment for Order Flow 12
Policy Issue: Treasury Market Disruptions 14
Investment Management 17
Policy Issue: Money Market Mutual Funds (MMFs) 19
Policy Issue: Private Equity 21
Investment Advisory Services 23
Policy Issue: Broker-Dealers and Registered Investment Advisors—SEC Fiduciary and Best Interest Standards 25
Policy Issue: Pension and Retirement Accounts—DOL Fiduciary Standards 28
Environmental, Social, and Governance (ESG) Investing 30
Policy Issue: The SEC's Proposed Climate Disclosure Rule 31
Policy Issue: Investment Manager ESG Compliance 35
Digital Assets 37
Policy Issue: SEC Digital Asset Jurisdiction 38
Policy Issue: Stablecoins 41
Capital Market Volatility and Market-Driven Events 43
Policy Issue: Tools to Ease Extreme Market Conditions 44
SEC Agency Operations 46
Policy Issue: SEC Rulemaking Agenda Under Chair Gensler 48

Figures

Figure 1. Capital Markets Financing for Nonfinancial Firms Compared with Other Funding Sources 1
Figure 2. Domestic Publicly Listed Companies: Number and Market Capitalization 7
Figure 3. Quarterly SPAC and Traditional IPO Deal Count 9
Figure 4. Equity Market Structure 11
Figure 5. The Importance of Financial Advice, Counseling, and Education 24
Figure 6. Global ESG Investing Adoption Levels 31
Figure 7. Modeled Market Volatility (VIX Index) over a Century 44
Figure 8. SEC Organizational Chart 48
Figure 9. Rules Proposed or Finalized by SEC Chairs 49

Tables

Table 1. Public and Private Funds Net Asset Value as of 2021 ($Billions) 18

Contacts

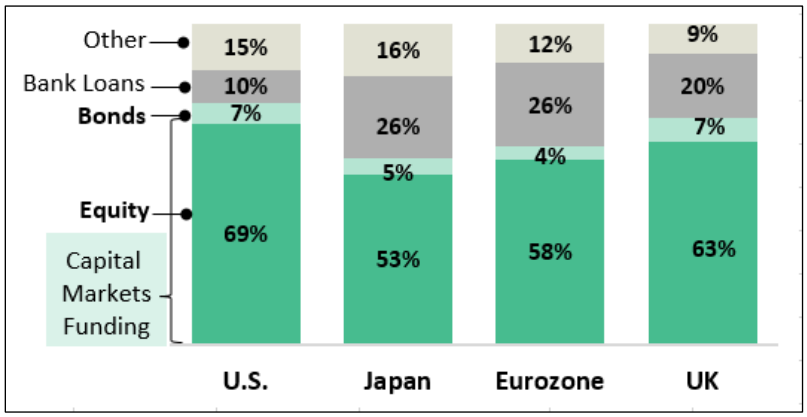
Author Information 51

Introduction

Capital markets are the part of a financial system where entities raise funding from investors by dealing in stocks, bonds, digital asset securities, and other investments. Capital markets instruments (securities) include (1) stocks, also called equity or shares, referring to ownership of a firm; (2) bonds, also called fixed income or debt securities, referring to the indebtedness or creditorship of a firm or a government entity; (3) digital asset securities, referring to digital representations of value in securities form; and (4) shares of investment funds, which are pooled investment vehicles that consolidate money from individual and institutional investors.[1]

As a main segment of the U.S. financial system, capital markets provide the largest sources of financing for U.S. nonfinancial companies.[2] U.S. capital markets offer around 76% of the financing for nonfinancial firms (**Figure 1**).[3] By contrast, capital markets play a less prominent role in other major economies, such as Japan, the Eurozone, and the United Kingdom.[4]

Figure 1. Capital Markets Financing for Nonfinancial Firms Compared with Other Funding Sources



Source: CRS, using data from SIFMA.

Notes: Data as of 2021. Eurozone = 19 EU-member states using the euro. Other = insurance reserves, trade credits, and trade advances.

Capital markets have continuously drawn policy attention, especially with regard to capital formation, investor protection, and efficient market operations. In recent Congresses, some capital markets legislative proposals, such as those that would amend the Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106), have evolved through multiple iterations.[5] Members of

[1] For more on the definition of *security*, see SEC Division of Corporate Finance Director William Hinman, "Digital Asset Transactions: When Howey Met Gary (Plastic)," speech delivered at Yahoo Finance All Markets Summit: Crypto, San Francisco, CA, June 14, 2018, https://www.sec.gov/news/speech/speech-hinman-061418.

[2] The calculation excludes financial firms, because the financial services sector focuses on asset allocation instead of the production of tangible goods.

[3] Securities Industry and Financial Markets Association (SIFMA), *2022 Capital Markets Fact Book*, July 2022, https://www.sifma.org/wp-content/uploads/2022/07/CM-Fact-Book-2022-SIFMA.pdf.

[4] SIFMA, *2022 Capital Markets Fact Book*.

[5] In 2012, the bipartisan Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106) established several new options for fundraising. Starting in 2015, parts of the Fixing America's Surface Transportation Act (P.L. 114-94)—referred to as JOBS Act 2.0—provided additional regulatory amendments for smaller companies. Following the JOBS Act and JOBS Act 2.0, Congress has considered numerous legislative proposals, building on existing JOBS Act

Congress have also introduced numerous standalone proposals targeting (1) securities offerings; (2) asset management; (3) investment advisers; (4) trading and market structure; (5) environmental, social, and corporate governance issues; (6) crypto and digital asset securities; and (7) Securities and Exchange Commission (SEC) operations. This report covers each of these seven selected policy areas in more detail.

The report starts with general background on capital markets operations and regulatory frameworks. It then examines prominent policy issues pertaining to the seven categories listed above. Selected SEC rulemakings or other proposed legislative or regulatory changes that may be of interest to Congress are described throughout the report. These issues serve as examples of policy debates. They are not exhaustive of all capital markets policy issues.

Background[6]

Capital markets involve many participants and operational components. The related activities face layers of securities regulation implemented by multiple regulatory bodies.

Market Composition and Key Players

Securities issuers, intermediaries, and investors are the main categories of participants in capital markets. Issuers include companies raising funding, the federal government, and municipalities that issue securities for fundraising purposes. Intermediaries such as broker-dealers, investment companies (e.g., mutual funds, private equity funds, and hedge funds), investment advisers, and securities exchanges facilitate the flow of capital from institutional and retail investors to securities issuers.

The U.S. capital markets measure over $100 trillion in size, composed of about $52 trillion in equity and $49 trillion in fixed income as of 2021.[7] At approximately 40% of the global equity and fixed income markets, U.S. capital markets are the largest and most relied-upon in the world. Market participants include about 7,400 reporting companies, 4,000 publicly traded companies, 28,000 registered entities, 24 national securities exchanges, nine credit rating agencies, and seven active registered clearing agencies.[8] Registered market participants include investment advisers, broker-dealers, mutual funds, exchange-traded funds, municipal advisers, and transfer agents.[9] These entities employ an estimated 940,000 individuals in the United States.[10]

provisions, including the JOBS and Investor Confidence Act of 2018 (House-amended S. 488 in the 115th Congress; JOBS Act 3.0)—a capital markets package of 32 proposals that passed House by a 406-4 vote in 2018. Around the 10th anniversary of the JOBS Act, some Members of Congress introduced another capital markets draft legislation package referred to as the JOBS Act 4.0 that included some JOBS Act 3.0 proposals as well as other proposed amendments to capital markets regulation.

[6] Authored by Eva Su, except for the "Regulatory Architecture" section, which is authored by Jay Sykes.

[7] SIFMA, *2022 Capital Markets Fact Book*. Also see SEC Chair Gary Gensler, *Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs*, September 15, 2022, https://www.sec.gov/news/testimony/gensler-testimony-housing-urban-affairs-091522. Note that market size fluctuates depending on market conditions.

[8] SEC, *Fiscal Year 2022 Congressional Budget Justification Annual Performance Plan*, https://www.sec.gov/files/fy-2022-congressional-budget-justification-annual-performance-plan_final.pdf.

[9] Most of these participants are discussed throughout this report. For more on transfer agents, see SEC, *Transfer Agents*, at https://www.sec.gov/divisions/marketreg/mrtransfer.shtml.

[10] SEC, *Strategic Plan Fiscal Years 2018-2022*, at https://www.sec.gov/files/SEC_Strategic_Plan_FY18-FY22_FINAL.pdf.

The SEC is the primary regulator overseeing capital markets. Aside from regulating market participants, the agency oversees other regulatory bodies, such as the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), the Securities Investor Protection Corporation, the Public Company Accounting Oversight Board, and the Financial Accounting Standards Board. With regard to broader marketplace regulation, the SEC coordinates with the Commodity Futures Trading Commission (CFTC), a separate federal financial regulator overseeing derivatives and commodities markets, regarding issues involving securities-based derivatives.[11]

State securities regulators also play a role in regulating intra-state securities markets.[12] While federal law preempts some categories of state securities regulation , certain areas—such as fraud and the regulation of small investment advisers—remain within the purview of state securities regulators.

Fundamental Concepts

This section provides conceptual background for understanding capital market operational practices and their regulation.

- **Regulatory philosophy.** The SEC is principally concerned with disclosure and transparency on the theory that investors should have sufficient information to make informed investment decisions.[13] The SEC's regulatory philosophy is different from that of banking regulators, which focus primarily on safety and soundness.[14] This difference occurs in part because of the federal government's role as an insurer of bank deposits. In capital markets, by contrast, investors generally assume the risk of loss.
- **Public and private securities offerings.** The SEC requires that offers and sales of securities, such as stocks and bonds, be either registered with the SEC or undertaken pursuant to a specific exemption.[15] The goal of registration is to ensure that investors receive key information on the securities being offered. Registered offerings, often called public offerings, are available to all types of investors. By contrast, securities offerings that are exempt from registration requirements are referred to as *private offerings* or *private placements*. Private offerings are available to institutions or individual investors who meet certain net worth or income thresholds, in addition to individuals who possess certain indications of technical expertise.
- **Retail and institutional investors.** Investors are often divided into retail investors (individuals and households) and institutional investors. Retail and institutional investors are generally perceived by stakeholders as having different capabilities to process information, comprehend investment risks, and sustain

[11] CFTC, "The Commission," https://www.cftc.gov/About/AboutTheCommission.

[12] SEC, "State Securities Regulators," https://www.investor.gov/introduction-investing/investing-basics/glossary/state-securities-regulators.

[13] For more details on securities disclosure and transparency, see CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su.

[14] Federal Reserve Bank of Chicago, "Safety and Soundness," https://www.chicagofed.org/banking/banker-resources/safety-and-soundness.

[15] SEC, "Registration Under the Securities Act of 1933," https://www.investor.gov/introduction-investing/investing-basics/glossary/registration-under-securities-act-1933.

financial losses. In general, retail investors are thought to warrant more protection from inadequate disclosure than institutional investors.

- **Primary and secondary markets.** The primary markets are where securities are originally issued through public and private securities offerings.[16] The secondary markets are where securities are traded to provide liquidity for existing securities. *Liquidity* is a common term that measures how quickly and easily transactions can occur without affecting an asset's price. Certain trading venues—for example, national securities exchanges and alternative trading systems—are essential enablers of secondary market trading and liquidity, which are important to the markets' overall health and efficiency.
- **Capital formation and investor protection.** Investor protection and capital formation are two of the SEC's core missions.[17] Some observers believe that the two goals stand in some tension. They argue that "light touch" regulation promotes capital formation by lowering firms' compliance costs, potentially at the expense of investor protection.[18] Others, however, have argued that the perceived tradeoff between the SEC's capital formation and investor protection goals is less stark, because robust investor protection induces greater participation in securities markets, which in turn lowers the cost of capital.[19]

Regulatory Architecture[20]

The regulatory framework governing the securities markets consists of several components.

First, as discussed, the SEC is the primary securities regulator and has broad authority over securities issuers, intermediaries, trading venues, and various participants in the securities industry.[21]

Second, the SEC oversees several self-regulatory organizations (SROs), which exercise front-line responsibility for regulating specific categories of market participants.[22] SROs in the securities industry include national securities exchanges;[23] FINRA, which regulates broker-dealers as the

[16] For more on primary and secondary markets, see Corporate Finance Institute, "Primary Market," December 7, 2022, https://corporatefinanceinstitute.com/resources/wealth-management/primary-market.

[17] SEC, "The Role of the SEC," https://www.investor.gov/introduction-investing/investing-basics/role-sec.

[18] For example, Mark Lebovitch and Jacob Spaid, "In Corporations We Trust: Ongoing Deregulation and Government Protections," Harvard Law School Forum on Corporate Governance, February 6, 2019, https://corpgov.law.harvard.edu/2019/02/06/in-corporations-we-trust-ongoing-deregulation-and-government-protections.

[19] For example, see former SEC Commissioner Luis Aguilar, "Capital Formation from the Investor's Perspective," December 3, 2012, https://www.sec.gov/news/speech/2012-spch120312laahtm.

[20] Authored by Jay Sykes.

[21] *See generally* LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION (6th ed. 2020). The Department of Justice also enforces laws pertaining to securities markets through its prosecution of criminal securities fraud. *See Securities and Commodities Fraud*, DEP'T OF JUSTICE (updated Sept. 26, 2022), https://www.justice.gov/criminal-fraud/securities-and-commodities-fraud.

[22] For more detailed discussions of the role that SROs play in the securities industry, see William A. Birdthistle & M. Todd Henderson, *Becoming a Fifth Branch*, 99 CORNELL L. REV. 1 (2013); Saule T. Omarova, *Rethinking the Future of Self-Regulation in the Financial Industry*, 35 BROOK. J. INT'L L. 665 (2010); Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?* 14 STAN. J.L. BUS. & FIN. 151 (2008).

[23] 15 U.S.C. § 78f.

only registered national securities association;[24] MSRB, which regulates municipal securities dealers and municipal advisors;[25] and clearing agencies.[26]

While the securities laws have outsourced certain rulemaking and enforcement activities to these SROs, the SEC retains the authority to approve or reject SRO rules, examine SROs to ensure they are discharging their responsibilities, and bring disciplinary actions against SROs for securities law violations.[27]

Third, the federal securities laws include a robust private remedial system in which investors can recover for losses caused by fraud and other wrongful conduct.[28] Private plaintiffs file hundreds of securities class actions each year.[29] In one popular metaphor, their attorneys represent "private attorneys general" who fill gaps in public law enforcement.[30]

Fourth, state securities regulators play a role in regulating the securities markets by enforcing what are colloquially known as "blue sky" laws.[31] While the National Securities Markets Improvement Act of 1996 preempted large portions of state securities-offering regulation,[32] state authorities retain a key role in policing securities fraud in addition to misconduct by broker-dealers and small investment advisers.[33]

Policy Issues by Market and Regulatory Components

As previously mentioned, capital markets policy debates involve several main issue categories, including (1) securities offerings; (2) asset management; (3) investment advisers; (4) trading and market structure; (5) environmental, social, and corporate governance issues; (6) crypto and digital asset securities; and (7) SEC agency operations.[34] This section provides an overview of key policy issues in each category.

[24] *Id*. § 78o-3.

[25] *Id*. § 78o-4.

[26] *Id*. § 78q-1.

[27] *Id*. § 78s.

[28] *See, e.g.*, 15 U.S.C. § 77k (prohibiting false statements in registration statements); *id*. § 78j(b) (prohibiting fraud in connection with the purchase or sale of securities in contravention of SEC rules); 17 C.F.R. § 240.10b-5 (prohibiting fraud in connection with the purchase or sale of securities).

[29] *See* Janeen McIntosh & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2021 Full Year Review*, NERA ECONOMIC CONSULTING (Jan. 25, 2022), https://www.nera.com/content/dam/nera/publications/2022/PUB_2021_Full-Year_Trends_012022.pdf.

[30] Judge Jerome Frank coined the term *private attorney general* in *Associated Industries of New York State, Inc. v. Ickes*, 134 F.2d 694, 704 (2d Cir. 1943).

[31] *Blue Sky Laws*, SEC. AND EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/glossary/blue-sky-laws (last visited Dec. 9, 2022).

[32] P.L. 104-290, 110 Stat. 3416 (1996).

[33] Andrew K. Jennings, *State Securities Enforcement*, 47 BYU L. REV. 67, 77-78 (2021).

[34] Some of these categories may not be mutually exclusive.

Securities Offerings

Companies turn to capital markets to raise funds from investors, a process referred to as a *securities offering*.[35] The companies that offer securities in exchange for funding are referred to as *securities issuers*. There are two main types of securities offerings. *Public* securities offerings are open to a wide range of investors (allowing a company to potentially raise more money from a larger investor pool) but must meet comprehensive registration and disclosure requirements, which may result in greater regulatory costs. By contrast, *private* securities offerings are exempt from certain SEC registration requirements but are generally available only to investors who are perceived as more sophisticated and able to sustain financial losses. Hence, securities regulation allows for wider or narrower access to investors and investment opportunities based on the amount of issuer disclosure and compliance.

Policy Issue: Growth of Private Securities Markets

Over the past decade, private securities offerings have eclipsed public offerings in volume.[36] The SEC estimates that between July 1, 2021, and June 30, 2022, issuers raised around $4.4 trillion in private offerings, almost four times the amount ($1.2 trillion) raised in public offerings.[37] In the previous year, private and public offerings were at $3.3 trillion and $1.7 trillion, respectively.[38]

Accompanying this trend is the decline in the number of publicly traded companies—a shift that suggests that public offerings may be growing less attractive or necessary for certain types of firms. While the number of publicly traded companies has declined, their market capitalization has increased (**Figure 2**).

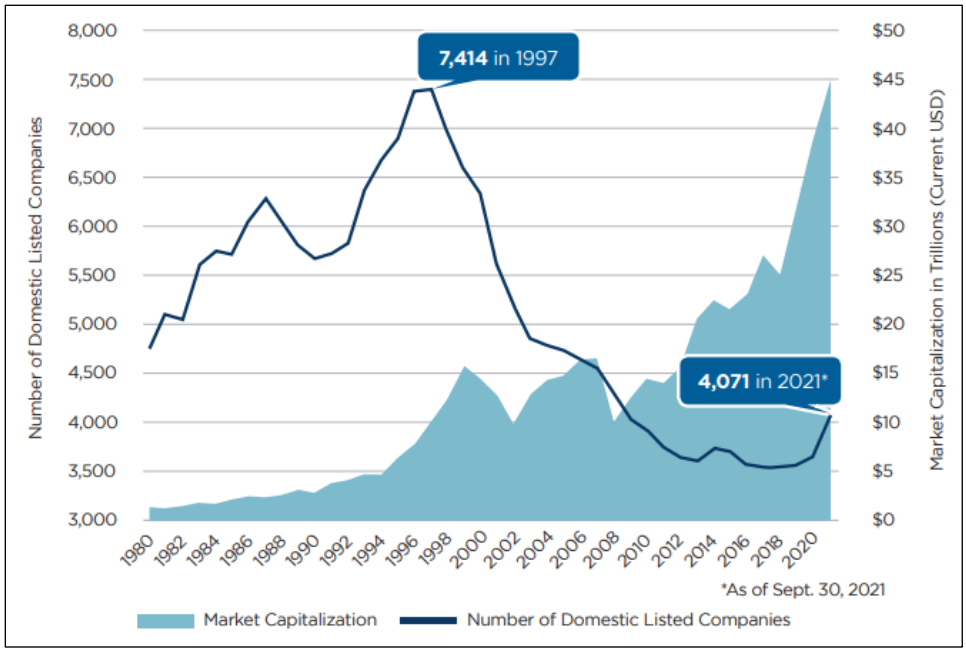
[35] For more on securities offerings, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[36] See SEC, *Concept Release on Harmonization of Securities Offering Exemptions*, June 18, 2019, Figure 1, https://www.sec.gov/rules/concept/2019/33-10649.pdf; and SEC, "SEC Seeks Public Comment on Ways to Harmonize Private Securities Offering Exemptions," press release, June 18, 2019, https://www.sec.gov/news/press-release/2019-97.

[37] SEC, Office of the Advocate for Small Business Capital Formation, *Annual Report: Fiscal Year 2022*, https://www.sec.gov/files/2022-oasb-annual-report.pdf.

[38] SEC, Office of the Advocate for Small Business Capital Formation *Annual Report: Fiscal Year 2022*.

Figure 2. Domestic Publicly Listed Companies: Number and Market Capitalization



Source: SEC, Office of the Advocate for Small Business Capital Formation, *Annual Report: Fiscal Year 2021*, https://www.sec.gov/files/2021-OASB-Annual-Report.pdf.

The policy debate surrounding private securities offerings is an illustration of the potential tradeoffs between investor protection and capital formation. The less onerous requirements of private offerings may facilitate capital formation by allowing issuers to raise funds more easily. On the other hand, the absence of rigorous disclosure requirements for private offerings may raise investor protection concerns. For example, less sophisticated retail investors may be unable to comprehend the higher risks that often accompany unregistered private offerings.

The increased importance of private securities offerings also represents a regulatory shift from a "one size fits all" regulatory approach, where public securities offerings were the dominant option for all issuers, to a broader selection of approaches applied to different fundraising methods. Additional regulatory options created through the private securities offerings process include more tailored regulations to account for factors such as the size of a firm's fundraising needs, the relevant industry (e.g., crowdfunding), scaled disclosure requirements, and investment limits to different types of investors when determining if the issuers are eligible for private offerings.

Some commentators have argued in favor of expanding access to private securities offerings based on principles of equal access.[39] As private markets continue to grow, some believe that investors may enjoy diversification benefits from allocating capital across the whole universe of public and private securities. In other words, this point of view reflects a belief that if retail investors cannot access a significant portion of investable assets, it is difficult for them to gain full exposure to the broader marketplace. In addition, while private markets may be riskier than public markets, they may also offer higher prospective nominal returns.

[39] SEC, Small Business Capital Formation Advisory Committee, *Expanding Retail Access to Private Markets*, November 2019, https://www.sec.gov/spotlight/sbcfac/expanding-retail-access-to-private-markets-finley.pdf.

Other commentators have expressed skepticism about the growth of private markets.[40] For example, some observers are concerned about investor protection and the lack of transparency in private securities offerings. Some argue that the expansion of private markets is attributable to deregulatory policy choices over the past decade, as opposed to organic growth.[41] They believe that the opacity of private securities markets could pose risks related to market disruptions and misallocation of capital.[42]

For Further Information

For questions about private securities offerings, contact Eva Su, Analyst in Financial Economics.

Additional reading on private and public securities offerings is available in:

CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su

CRS In Focus IF10747, *Private Securities Offerings: Background and Legislation*, by Eva Su

CRS In Focus IF11278, *Accredited Investor Definition and Private Securities Markets*, by Eva Su

CRS In Focus IF10855, *Capital Access: IPO and "IPO On-Ramp"*, by Eva Su

CRS In Focus IF10848, *Capital Access: SEC Regulation A+ ("Mini-IPO")*, by Eva Su

Policy Issue: Special Purpose Acquisition Companies (SPACs)

A SPAC is a type of company that raises capital through an initial public offering (IPO) with the intention to use the proceeds to acquire other existing, operating companies at a later time. Because the investors often do not know exactly what company or companies their money will be used to buy, SPACs are sometimes referred to as "blank check" companies. Unlike traditional IPOs, which offer extensive upfront disclosures about the operating companies,[43] SPACs do not have commercial operations at the time of the IPOs. SPACs first appeared in the 1980s but have gained popularity in recent years, especially since 2020. The IPO deal count for SPACs reached a record high in 2021,[44] substantially surpassing traditional IPOs. However, SPAC offerings subsided in 2022 (**Figure 3**).[45]

[40] Former SEC Commissioner Allison Lee, "Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy," October 12, 2021, https://www.sec.gov/news/speech/lee-sec-speaks-2021-10-12.

[41] Lee, "Going Dark."

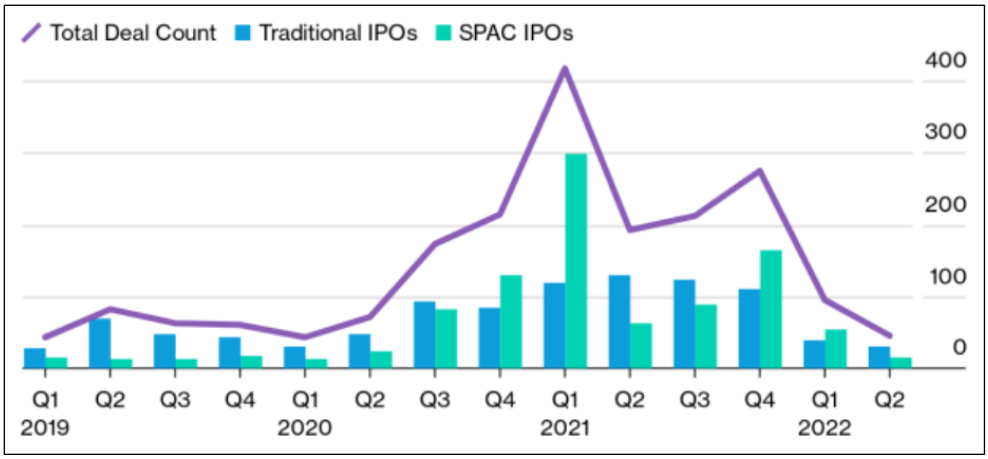
[42] Lee, "Going Dark."

[43] SEC, *Investor Bulletin: Investing in an IPO*, https://www.sec.gov/investor/alerts/ipo-investorbulletin.pdf; and Latham and Watkins, *US IPO Guide*, June 15, 2022, https://www.lw.com/admin/upload/SiteAttachments/lw-us-ipo-guide.pdf.

[44] Max Bazerman and Paresh Patel, "SPACs: What You Need to Know," *Harvard Business Review*, July-August 2021, https://hbr.org/2021/07/spacs-what-you-need-to-know.

[45] Preston Brewer, "IPOs Fall to Earth; a Requiem for SPACs?," *Bloomberg Law*, July 8, 2022, https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-ipos-fall-to-earth-a-requiem-for-spacs; and Aziz Sunderji and Amrith Ramkumar, "SPAC Activity in July Reached the Lowest Levels in Five Years," *Wall Street Journal*, August 17, 2022, https://www.wsj.com/articles/spac-activity-in-july-reached-the-lowest-levels-in-five-years-11660691758.

Figure 3. Quarterly SPAC and Traditional IPO Deal Count



Source: *Bloomberg*.

Note: Deals include IPOs of at least $1 million priced on U.S. exchanges.

SPACs-related policy issues include

- **Regulatory treatment.** As SPACs grew from a market niche to a popular alternative to traditional IPOs within a short period of time, questions arose regarding equitable regulatory treatment. Many market participants view SPACs as a "backdoor" to a public listing,[46] because such offerings have fewer upfront disclosure requirements and can be completed more quickly than a traditional IPO.
- **Investor protection.** SPAC investors purchase their shares without knowing the specifics of a SPAC's future target company. If investors do not like the proposed acquisition, they can get their money back during the so-called de-SPAC process (when the SPAC acquires a target operating company). Despite the availability of the de-SPAC process, SPAC critics are concerned that a lack of transparency surrounding such offerings could be risky for investors. In particular, critics have noted that many SPACs have been associated with fraud and manipulation.[47]
- **Performance relative to traditional IPOs.** SPACs in general have a reputation for underperforming traditional IPOs and other market benchmarks.[48] Some academic research shows that, while public market SPAC investors may have suffered losses or low returns, SPAC sponsors (who create the SPACs) realized high average annualized returns on their initial investments.[49]
- **Incentive structure.** SPAC sponsors' compensation (also called a "promote") is typically high and not contingent upon meeting financial targets.[50] Some believe

[46] Kuo-Hua Fan, "What Are the Similarities and Differences Between SPAC and Backdoor Listing?" *Lexology*, https://www.lexology.com/library/detail.aspx?g=518725a9-94b7-4b63-8cb5-9b955a1cd321.

[47] For example, report by Office of Senator Elizabeth Warren, *The SPAC Hack: How SPACs Tilt the Playing Field and Enrich Wall Street Insiders*, May 2022, https://www.warren.senate.gov/imo/media/doc/SPACS.pdf.

[48] Noah Buhayar, Tom Maloney, and Zijia Song, "Wall Street Is Churning Out SPACs at Investors' Peril," *Bloomberg*, November 16, 2021, https://www.bloomberg.com/graphics/2021-what-is-a-spac-wall-street-investor-risk.

[49] Jay Ritter et al., "SPACs," *Review of Financial Studies*, October 12, 2022, https://ssrn.com/abstract=3775847.

[50] Ramey Layne and Brenda Lenahan, "Special Purpose Acquisition Companies: An Introduction," *Harvard Law*

that because of the pressure to conduct a de-SPAC within a specified period of time, some SPAC sponsors may be more interested in getting any deal done rather than getting a good deal done in order to retain the promotes.[51] Additionally, the size of a SPAC's promote draws concern for some. For example, Opendoor's $4.8 billion de-SPAC transaction, which included $414 million in SPAC IPO proceeds, awarded the sponsors $60 million in shares.[52] The size of the typical sponsor compensation reduces returns to public investors, sometimes substantially.

- **Exchange listing standards.** Because of SPACs' increased popularity in recent years, stock exchanges have tried to relax their listing standards to attract such companies. For example, some exchanges proposed reducing certain SPAC public shareholder thresholds, but the SEC rejected the proposals.[53] Some argue that loosening SPAC listing standards might lower the bar for investor protection.[54]

SEC Proposed Rule

The SEC proposed a new rule on SPACs on March 30, 2022, that aims to increase disclosure and align certain SPAC IPO requirements with those that apply to traditional IPOs.[55] Provisions in the proposal include (1) increased disclosure for SPAC and de-SPAC processes; (2) amended regulatory treatment of certain shell company mergers and related financial statement requirements; (3) amended guidance regarding the use of projections in SEC filings, as well as when projections are disclosed in connection with de-SPAC transactions; and (4) a safe harbor under the Investment Company Act of 1940 for SPACs that meet qualifying criteria such as maintaining high asset quality and completing the de-SPAC transitions within a certain time period.[56] The SEC's proposed rule reportedly contributed to the cooling down of the SPAC market in 2022.[57]

School Forum on Corporate Governance, July 6, 2018, https://corpgov.law.harvard.edu/2018/07/06/special-purpose-acquisition-companies-an-introduction.

[51] For example, Duncan Lamont, "The Pros, Cons and Incentives Behind the SPAC-Craze Sweeping Markets," *Schroders*, March 31, 2021, https://www.schroders.com/en/us/insights/equities/the-pros-cons-and-incentives-behind-the-spac-craze-sweeping-markets.

[52] Ortenca Aliaj and Eric Platt, "Share Reward for Founder of Blank-Cheque Company in Focus After $4.8bn Opendoor Deal," *Financial Times*, September 15, 2020, https://www.ft.com/content/ccd2dc37-d7e4-497d-92c6-9d3b86963e0a.

[53] SEC, Self-Regulatory Organizations; New York Stock Exchange LLC; Order Disapproving a Proposed Rule Change to Amend the Listed Company Manual for Special Purpose Acquisition Companies to Reduce the Continued Listing Standards for Public Holders from 300 to 100 and to Enable the Exchange to Exercise Discretion to Allow Special Purpose Acquisition Companies a Reasonable Time Period Following a Business Combination to Demonstrate Compliance with the Applicable Quantitative Listing Standards, June 14, 2019, https://www.sec.gov/rules/sro/nyse/2019/34-86117.pdf.

[54] For example, Jeffrey Mahoney, General Counsel, Council of Institutional Investors, letter to the SEC, February 11, 2019, https://www.sec.gov/rules/sro/nyse/2019/34-86117.pdf.

[55] SEC, "SEC Proposes Rules to Enhance Disclosure and Investor Protection Relating to Special Purpose Acquisition Companies, Shell Companies, and Projections," press release, March 30, 2022, https://www.sec.gov/news/press-release/2022-56.

[56] SEC, "Special Purpose Acquisition Companies, Shell Companies, and Projections," 87 *Federal Register* 29458-29574, May 13, 2022.

[57] Brewer, "IPOs Fall to Earth."

For Further Information

For questions about SPACs, contact Eva Su, Analyst in Financial Economics.

Additional reading on SPACs is available in CRS In Focus IF11655, *SPAC IPO: Background and Policy Issues*, by Eva Su.

Securities Trading and Market Structure

As mentioned, securities are initially created and offered in the primary market and are subsequently traded in the secondary market. A trading system that brings together multiple securities buyers and sellers generally has to register with the SEC as a national securities exchange or operate as an alternative trading system (ATS) and register as a broker-dealer.[58]

A national securities exchange is a securities exchange that has registered with the SEC under Section 6 of the Securities Exchange Act of 1934.[59] ATSs are SEC-regulated electronic trading systems that match securities orders for buyers and sellers. Some ATSs are referred to as "dark pools" because, unlike national securities exchanges, they do not publicly display the size and price of their orders.[60] A broker is any person engaged in securities buying and selling for others, while a dealer is any person engaged in securities transactions from his or her own account. Because most securities firms act as both brokers and dealers, they are generally referred to as broker-dealers.

Figure 4. Equity Market Structure

Source: SEC.

Figure 4 illustrates the typical equity market structure for a stock trade.[61] When an investor goes through a broker-dealer to place a trade, the broker-dealer could route the customer order to one

[58] See SEC Regulation National Market System and Regulation Alternative Trading Systems. 17 C.F.R. §§200, 201, 230, 240, 242, 249, and 270.

[59] 15 U.S.C. §78f.

[60] FINRA, "Where Do Stocks Trade?," December 3, 2021, https://www.finra.org/investors/insights/where-do-stocks-trade.

[61] SEC, *Staff Report on Equity and Options Market Structure Conditions in Early 2021*, October 14, 2021,

of several execution venues. These venues include national securities exchanges and off-exchange venues such as ATSs, single-dealer platforms, and wholesalers (also referred to as market makers).[62] Transactions also go through a *clearance and settlement* process, whereby transaction details are verified and money and shares are transferred between the accounts of the buyer and seller.

Many regulatory requirements promulgated by the SEC and FINRA govern securities trading and market structure. These requirements include rules designed to promote market transparency (e.g., publicly displayed quotations and other disclosure and reporting requirements), fair access and representation (e.g., standards of care for customer transactions to mitigate conflicts of interest and other risks), intermarket access, sub-penny pricing restrictions, and market data consolidation and distribution.[63]

Policy Issue: Payment for Order Flow

Retail investor trading experienced an unprecedented surge in 2020 and 2021.[64] A significant amount of those trades were managed by major discount broker-dealers such as Charles Schwab, E*Trade, Robinhood, and TD Ameritrade. Among the factors that helped drive the surge is zero-commission trading, a practice that is profitable in part because of what is known as "payment for order flow" (PFOF), a controversial rebate paid by market makers to the broker-dealers.[65] In a PFOF arrangement, market makers—that is, wholesale brokerage firms alternatively known as wholesalers or internalizers—make cash payments to retail broker-dealer firms in exchange for marketable retail customer stock order flows.[66] The market makers—such as Citadel, Morgan Stanley, Susquehanna, Virtu, and Wolverine—then typically execute the orders in-house in a process called *internalization*. By various accounts, PFOF has played a significant role in helping lower retail broker-dealer commissions, thereby facilitating zero-commission trading.

For decades, PFOF has been the subject of policy debates. The uproar in early 2021 surrounding the behavior of GameStop stock—which was traded by various broker-dealers, including those who received PFOF—has helped to renew such debates.[67] At the center of policy debates over the arrangements is the broker-dealer's duty of best execution, which requires a broker-dealer to seek the most favorable terms for a customer's transaction.[68] Some commentators have expressed concern that PFOF generates conflicts of interest that may interfere with a broker-dealer's compliance with its best-execution duties.

---

https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf.

[62] A market maker is a firm that stands ready to buy or sell a stock at publicly quoted prices. For more information, see SEC, *Market Centers: Buying and Selling Stock*, https://www.sec.gov/fast-answers/answersmarket.

[63] Regulation NMS and Regulation ATS. 17 C.F.R. §242.600-614 and 17 C.F.R. §242.300-304.

[64] Eric Platt, Madison Darbyshire, and Kate Duguid, "Retail Investors Take Shelter in Cash After Stock Market Rout," *Financial Times*, October 20, 2022, https://www.ft.com/content/d62cb3f3-853a-4000-a46d-2f6e966954e8.

[65] Katherine Doherty and Lydia Beyoud, "Why Payment for Order Flow Made Trades Free but Left SEC Skeptical," *Washington Post*, September 23, 2022, https://www.washingtonpost.com/business/why-payment-for-order-flow-made-trades-free-but-left-sec-skeptical/2022/09/23/edc91bc2-3b68-11ed-b8af-0a04e5dc3db6_story.html.

[66] A marketable order is an order for a securities trade that is immediately executable against previously provided securities trade orders.

[67] For more on the GameStop market event, see CRS Insight IN11591, *GameStop-Related Market Volatility: Policy Issues*, by Eva Su; and CRS Insight IN11615, *GameStop-Related Market Volatility: What Happened?*, by Gary Shorter.

[68] FINRA, "Best Execution," https://www.finra.org/rules-guidance/guidance/reports/2021-finras-examination-and-risk-monitoring-program/best-execution.

Supporters of PFOF argue that the arrangement benefits investors by subsidizing low- or zero-commission rates and other services.[69] In addition, they note that marketable retail orders that tend to be routed to the PFOF rebaters must be executed under best-execution protocols and are executed at the national best bid or offer or at a price that improves on it.[70] However, concerns have arisen that because broker-dealers may not pass PFOF rebates on to their clients, they may have economic incentives to send retail orders to rebating market makers that are the most beneficial to them instead of the clients, creating potential conflicts over their duty of best execution.[71] PFOF has been effectively banned in the United Kingdom, Australia, and Canada due to such conflict-of-interest concerns.[72] Also, the European Union is reportedly reviewing the practice.[73]

Academic research has not formed a consensus regarding whether PFOF would improve or harm price execution. One study has found that the shift to PFOF-facilitated zero commissions was beneficial to retail investors in terms of their overall costs of trading.[74] In contrast, another study found that trades executed at the best-quoted prices surged after the United Kingdom effectively banned PFOF.[75] Other research found that PFOF-facilitated zero commissions led to overall improvements in market quality, but retail investors received less price improvement per share.[76] A 2022 study of 85,000 simultaneous market orders with five broker-dealers showed that PFOF does not appear to harm price execution.[77]

SEC Proposed Rules

On December 14, 2022, the SEC proposed multiple rules and amendments to reform the equity market structure.[78] This initiative includes proposals that would require certain retail orders to be

[69] Senate Banking Committee, "Toomey Launches Effort to Preserve Commission-Free Trading," press release, October 28, 2021, https://www.banking.senate.gov/newsroom/minority/toomey-launches-effort-to-preserve-commission-free-trading.

[70] Senate Banking Committee, "Toomey Launches Effort."

[71] Testimony of SEC Chair Gary Gensler in U.S. Congress, House Committee on Financial Services, May 6, 2021, https://www.sec.gov/news/testimony/gensler-testimony-20210505.

[72] Bart Zhou Yueshen, Markus Baldauf, and Joshua Mollner, "Banning Payment for Order Flow May Benefit No One," *Insead*, September 29, 2022, https://knowledge.insead.edu/economics-finance/banning-payment-order-flow-may-benefit-no-one.

[73] European Union, Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) No 600/2014 as Regards Enhancing Market Data Transparency, Removing Obstacles to the Emergence of a Consolidated Tape, Optimising the Trading Obligations and Prohibiting Receiving Payments for Forwarding Client Orders, November 25, 2021, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0727.

[74] Samuel Adams, Connor Kasten, and Eric K. Kelley, "Do Investors Save When Market Makers Pay? Retail Execution Costs Under Payment for Order Flow Models," *Evidence Investor*, January 2021, https://www.evidenceinvestor.com/evidence/do-investors-save-when-market-makers-pay-retail-execution-costs-under-payment-for-order-flow-models/.

[75] CFA Institute, "Payment for Order Flow in the United Kingdom," 2016, https://www.cfainstitute.org/-/media/documents/article/position-paper/payment-for-order-flow-united-kingdom.pdf.

[76] Pankaj K. Jain et al., "Trading Volume Shares and Market Quality: Pre- and Post-Zero Commissions," *Evidence Investor*, December 2021, https://www.evidenceinvestor.com/evidence/trading-volume-shares-and-market-quality-pre-and-post-zero-commissions/.

[77] Christopher Schwarz et al., "The 'Actual Retail Price' of Equity Trades," SSRN, September 14, 2022, http://dx.doi.org/10.2139/ssrn.4189239.

[78] SEC, *SEC Proposals Related to Market Structure*, December 22, 2022, https://www.sec.gov/newsroom/market-structure-proposals-december-2022; SEC, "Order Competition Rule," 88 *Federal Register* 128-245, January 3, 2023; SEC, "Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders," 88 *Federal Register* 80266-80359, December 29, 2022; SEC, "Regulation Best Execution," 88 *Federal Register* 5440-5556, January 27, 2023; SEC, "Disclosure of Order Execution Information," 88 *Federal Register* 3786-3905, January

put up for auction at securities exchanges or other trading venues before they could be executed internally by any trading venues that restrict order-by-order competition. If implemented, the rule may reduce the attractiveness of PFOF to wholesalers.[79] The SEC also proposed a new rule on Regulation Best Execution for the first time (while FINRA already has a rule that relates to best execution).[80] The rule aims to strengthen broker-dealer best execution practices, including those governing PFOF. For more on SEC-proposed rules, see CRS In Focus IF12336, *SEC-Proposed Regulations to Reform Stock Trading*, by Eva Su.

For Further Information

For questions about PFOF, contact Gary Shorter, Specialist in Financial Economics.

For questions about the SEC's equity market structure reform, contact Eva Su, Analyst in Financial Economics.

Additional reading on PFOF, Robinhood, and GameStop-related market events is available in:

CRS In Focus IF11800, *Broker-Dealers and Payment for Order Flow*, by Gary Shorter

CRS In Focus IF12332, *Payment for Order Flow: The SEC Proposes Reforms*, by Gary Shorter

CRS In Focus IF12336, *SEC-Proposed Regulations to Reform Stock Trading*, by Eva Su

CRS In Focus IF11663, *Robinhood, the Fintech Discount Broker: Recent Developments and Concerns*, by Gary Shorter

CRS Insight IN11591, *GameStop-Related Market Volatility: Policy Issues*, by Eva Su

Policy Issue: Treasury Market Disruptions

The $24 trillion U.S. Treasury securities market is considered one of the most important financial markets in the world.[81] The market provides a low-risk (backed by the full faith and credit of the U.S. government) and liquid asset for global investors while raising funding to finance U.S. federal spending. Any event that significantly disrupts Treasury market functions, such as sudden increases in price volatility or reductions in liquidity, could cause distress in the global financial system. Market disruptions in 2014, 2019, and 2020 show that the Treasury market is not immune to such disruptions.[82]

Multiple authorities are responsible for regulating or operating various components of the Treasury market. For example, the Department of the Treasury is responsible for securities issuance, while the Federal Reserve (Fed) executes auctions and buybacks (the latter are rare). Trading in Treasury securities is facilitated mainly by brokers and dealers. The Government Securities Act of 1986 (P.L. 99-571) establishes the broker-dealer regulatory framework in the government securities market. The Trade Reporting and Compliance Engine (TRACE) is the

20, 2023.

[79] SEC, "SEC Proposes Rule to Enhance Competition for Individual Investor Order Execution," press release, December 14, 2022, https://www.sec.gov/news/press-release/2022-225; SEC, "Order Competition Rule," 88 *Federal Register* 128-245, January 3, 2023.

[80] SEC, "SEC Proposes Regulation Best Execution," press release, December 14, 2022, https://www.sec.gov/news/press-release/2022-226; and FINRA, "Rule 5310 Best Execution and Interpositioning," https://www.finra.org/rules-guidance/rulebooks/finra-rules/5310.

[81] SIFMA, "U.S. Treasury Securities Statistics," October 7, 2022, https://www.sifma.org/resources/research/us-treasury-securities-statistics.

[82] For more discussions of Treasury market events, see CRS In Focus IF12012, *Treasury Securities Market Disruptions and Policy Issues*, by Eva Su.

main system for consolidating Treasury securities transaction data and reporting. FINRA operates TRACE with the involvement of the Treasury, SEC, Fed, and other official entities. The process for clearing and settling transactions in Treasury securities is facilitated by entities operated by or under the oversight of the Fed and the SEC. Treasury derivatives markets generally include Treasury futures, options, swaps, and futures on indices related to Treasuries, among other instruments. The CFTC oversees these Treasury derivatives markets.

Policy discussions about the Treasury market focus on diagnosing the causes of market disruptions and identifying potential methods to prevent or mitigate the related risks. Abnormal events in the Treasury market and their increased frequency have revealed areas of structural vulnerability. According to a number of observers, the root cause of the increase in Treasury market disruptions relates to the rapid growth of the market's size, which now outstrips dealers' intermediation and market-making capacity.[83] Specifically, the nominal amount of Treasury securities held by the public more than tripled between 2008 and 2020, placing pressure on intermediation.

Various government agencies, industry practitioners, and think tanks have made a number of recommendations in recent years to address these challenges, some of which are broadly described below.[84] Critics of these recommendations assert that some proposals would entail undue government intervention and impose additional costs on market participants. Proposed policy options include the following:

- **Enhance market-making capacity** through the creation of a facility at the Fed—which would provide permanent, broad, and direct access to the Fed's financing—in an effort to ensure intermediaries' confidence in market making. The Fed launched a related standing facility in 2021 to provide a backstop for Treasury markets.[85]
- **Increase safeguards** including potential registration of certain large trading firms as dealers under securities law and expand Treasury securities trading regulation (e.g., through changes to SEC Regulation ATS).
- **Mandate central clearing of more trading activities** through a central counterparty clearinghouse. Central clearing could reduce counterparty risk, increase transparency, and expand intermediaries' balance sheet capacity (e.g., through "netting").[86] The specific steps could include the expansion of central clearing to all Treasury securities and repos.
- **Increase market transparency and monitoring** by expanding reporting, disclosure, and data collection and tracking. Recommendations along these lines include potential enhancements to FINRA's TRACE reporting for Treasury

[83] See, for example, Nellie Liang and Pat Parkinson, "Enhancing Liquidity of the U.S. Treasury Market Under Stress," Brookings Institution, December 16, 2020, p. 1, https://www.brookings.edu/wpcontent/uploads/2020/12/WP72_Liang-Parkinson.pdf.

[84] Group of Thirty, *U.S. Treasury Markets Steps Toward Increased Resilience*, July 1, 2021, https://group30.org/images/uploads/publications/G30_U.S_._Treasury_Markets-_Steps_Toward_Increased_Resilience__1.pdf; and Inter-Agency Working Group on Treasury Market Surveillance, *Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report*, November 8, 2021, https://home.treasury.gov/system/files/136/IAWG-Treasury-Report.pdf.

[85] Federal Reserve, "Standing Repurchase Agreement (Repo) Facility," https://www.federalreserve.gov/monetarypolicy/standing-overnight-repurchase-agreement-facility.htm.

[86] For more on netting, see Michael Fleming and Frank Keane, *The Netting Efficiencies of Marketwide Central Clearing*, April 2021, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr964.pdf.

securities. Among the enhancements under consideration is a shortened trade reporting time frame. Others have recommended that Treasury securities transactions be publicly disclosed like the TRACE reporting for corporate bonds.[87]

- **Establish a new all-to-all trading platform** that could allow major Treasury market participants (e.g., asset managers, dealers, and nonbank liquidity providers) to trade directly with any other participants. Some believe this potential new platform could be especially helpful during market distress when traditional intermediaries could face constraints.[88]

SEC and FINRA Proposed Rules

The SEC proposed two new rules in 2022 that align with some of the recommendations discussed above. In January 2022, the SEC proposed amending Regulation ATS to include Treasury market platforms.[89] This proposal would apply Regulation ATS provisions to platforms that trade Treasury securities or repurchase and reverse repurchase agreements on Treasury securities. In September 2022, the SEC proposed amendments to Rule 17Ad-22 to impose requirements on covered clearing agencies providing central counterparty services for Treasury securities.[90] The proposal requires Treasury market-clearing agencies to adopt policies and procedures designed to require their members to submit for clearing certain specified secondary market transactions involving Treasury securities. Because only around 13% of Treasury securities cash transactions were centrally cleared as of 2017,[91] the proposal's requirements could have broad potential effects on market practices.

FINRA filed two proposed rules with the SEC and published a regulatory notice with regard to the expansion of TRACE reporting requirements in 2022.[92] The proposals partially address the

[87] Group of Thirty, *U.S. Treasury Markets Steps Toward Increased Resilience*, p. 17.

[88] Alain Chaboud et al., *All-to-All Trading in the U.S. Treasury Market*, Federal Reserve Bank of New York, October, 2022, https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1036.pdf; Libby Cantrill et al., "How Can Policymakers Improve the Functioning of the U.S. Treasury Market?," *PIMCO*, September 8, 2022, https://www.pimco.com/en-us/insights/viewpoints/in-depth/how-can-policymakers-improve-the-functioning-of-the-us-treasury-market; and Inter-Agency Working Group for Treasury Market Surveillance, *Enhancing the Resilience of the U.S. Treasury Market: 2022 Staff Progress Report*, November 10, 2022, https://home.treasury.gov/system/files/136/2022-IAWG-Treasury-Report.pdf.

[89] SEC, "SEC Proposes Amendments to Include Significant Treasury Markets Platforms Within Regulation ATS," press release, January 26, 2022, https://www.sec.gov/news/press-release/2022-10; SEC, "Amendments Regarding the Definition of 'Exchange' and Alternative Trading Systems (ATSs) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities," 87 *Federal Register* 15496-15696, April 18, 2022.

[90] SEC, "SEC Proposes Rules to Improve Risk Management in Clearance and Settlement and to Facilitate Additional Central Clearing for the U.S. Treasury Market," press release, September 14, 2022, https://www.sec.gov/news/press-release/2022-162; SEC, "Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule with Respect to U.S. Treasury Securities," 87 *Federal Register* 64610-64682, October 25, 2022.

[91] U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, SEC, and CFTC, *Recent Disruptions and Potential Reforms in the U.S. Treasury Market: A Staff Progress Report*, November 8, 2021, https://home.treasury.gov/system/files/136/IAWGTreasury-Report.pdf.

[92] FINRA, *SR-FINRA-2022-011*, https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-011; FINRA, *SR-FINRA-2022-013*, https://www.finra.org/rules-guidance/rule-filings/sr-finra-2022-013; and FINRA, *Regulatory Notice 22-12*, https://www.finra.org/rules-guidance/notices/22-12.

previously discussed policy concern about TRACE reporting time. Related costs could occur when FINRA member firms update their reporting systems to enable the proposed compliance.[93]

For Further Information

For questions about Treasury securities, contact Eva Su, Analyst in Financial Economics.

For questions about TRACE, contact Gary Shorter, Specialist in Financial Economics.

Additional reading on Treasury securities is available in CRS In Focus IF12012, *Treasury Securities Market Disruptions and Policy Issues*, by Eva Su.

Investment Management

The asset management industry is large and complex. Asset management companies—also referred to as investment management companies, money managers, funds, or investment funds—are collective investment vehicles that pool money from various individual or institutional investor clients and invest on their behalf.[94] As the industry's primary regulator, the SEC oversees asset managers with more than $120 trillion in assets under management combined.[95]

The industry has grown substantially due to retail investors' increased reliance on asset managers to invest their money for them rather than investing their own money themselves. Nearly half (47.9%) of all U.S. households owned some form of SEC-registered investment company funds as of 2021.[96] When operating as expected, the industry functions to pool assets, share risks, allocate resources, and produce research information.

Asset management companies offer public or private funds. These two types of funds are distinguished by the kinds of investors who can access them and by the regulation applied to them.[97]

Public funds—such as mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts—are broadly accessible to investors of all types. Private funds are limited to

[93] Russell Fecteau and Margaret Blake, "FINRA Seeks to Expand Reporting Requirements for Transactions in TRACE-Eligible Securities," *Morgan Lewis*, June 14, 2022, https://www.morganlewis.com/pubs/2022/06/finra-seeks-to-expand-reporting-requirements-for-transactions-in-trace-eligible-securities.

[94] While an investment company could manage multiple funds, in common usage, the word *fund* is also used interchangeably to describe an investment management company. For this report, unless noted otherwise, funds are also referred to as investment companies. Per Title 15, Section 80a-3(a)(1), of the *U.S. Code*, the statutory definition of *investment company* is any issuer that "(A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis."

[95] The SEC's Division of Investment management oversees around $128 trillion in regulatory assets under management as of 2022. For more details, see William Birdthistle, Director of SEC Division of Investment Management, "Remarks at PLI: Investment Management 2022," July 26, 2022, https://www.sec.gov/news/speech/birdthistle-remarks-pli-investment-management-2022-072622.

[96] Investment Company Institute, *2022 Investment Company Fact Book*, https://www.ici.org/system/files/2022-05/2022_factbook.pdf.

[97] For more on public and private funds, including descriptions of different types of public and private funds and their regulatory frameworks, see CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su.

institutional and certain retail (individual) investors who are perceived as better positioned to understand and tolerate risks. The main types of private funds are private equity, hedge fund, venture capital, and family office.[98]

Additionally, a number of intermediaries, such as investment advisers and custodians, provide distribution channels, safeguards, and other essential services to investors and fund issuers. As of 2021, public fund net asset value (NAV) totaled around $35 trillion, and private fund NAV totaled around $14 trillion.[99] NAV is the total value of a fund's assets minus liabilities and is thus generally smaller than the fund's assets under management. Per-share NAV often provides an indication of reference for the price at which a share of a fund can be purchased. **Table 1** illustrates the size of different types of public and private funds as measured by NAV.[100]

Table 1. Public and Private Funds Net Asset Value as of 2021 ($Billions)

Public Funds	
Mutual Fund	$26,964
Exchange-Traded Fund (ETF)	$7,191
Closed-End Fund	$309
Unit Investment Trust	$95
Total	$34,559
Private Funds	
Private Equity	$5,729
Hedge Fund	$5,122
Venture Capital	$308
Other Private Funds	$2,869
Total	$14,028

Source: CRS using data from the SEC and Investment Company Institute.

Notes: The table illustrates net asset value (NAV), not gross asset value. NAV is the total value of assets minus liabilities. Closed-end fund data include preferred share classes. Total public fund NAV includes mutual fund holdings of closed-end funds and ETFs. Private funds data as reported in SEC Form PF, Question 9. The private fund types are not mutually exclusive. Other private funds include liquidity funds, real estate funds, securitized asset funds, and others.

The business practices of and regulatory requirements for asset management companies vary. Investment funds differ based on their asset risk profile, investor access, portfolio company composition, and ease of buying or selling their shares, among other things.

The industry is governed by a somewhat fragmented regulatory regime stemming from several different statutes.[101] Most of the regulatory framework was created in the 1930s and 1940s, but

[98] See CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su.

[99] SEC, *Private Funds Statistics*, July 19, 2022 https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q4.pdf; and Investment Company Institute, *2022 Investment Company Fact Book*.

[100] SEC, "Net Asset Value," https://www.investor.gov/introduction-investing/investing-basics/glossary/net-asset-value.

[101] The main statutes that govern the asset management industry at the federal level include the Investment Company Act of 1940 (P.L. 76-768), the Investment Advisers Act of 1940 (P.L. 76-768), the Securities Act of 1933 (P.L. 73-22), and the Securities Exchange Act of 1934 (P.L. 73-291). For more on securities laws, see CRS In Focus IF11422,

the business practices and trends affecting the industry are evolving. Examples of this evolution include (1) the rapid growth of the industry; (2) the increasing dependence of American businesses on capital markets financing; (3) the shift from active to passive investment styles; and (4) the expansion of the private securities markets, including the growth of private funds.[102] This section will discuss policy issues relating to money market mutual funds and private equity in more detail.

Policy Issue: Money Market Mutual Funds (MMFs)

An MMF is a mutual fund that, under SEC Rule 2a-7, can invest only in high-quality and short-term securities.[103] MMFs are considered safe investment options and common alternatives to bank deposits, although they are not federally insured like bank deposits. MMFs provide financing for federal and local governments, private corporations, and (indirectly) households. They also serve as investment and cash management tools for retail and institutional investors. The MMF industry also offers short-term funding for businesses and government entities to help them pay for things such as operational expenses, schools, bridges, or other financial obligations. MMFs are significant holders of U.S. government securities, commercial paper, municipal debt, and certificates of deposits.[104] For example, MMFs are especially important for the commercial paper market, an integral part of the short-term funding markets for financing businesses and households. MMFs held around 20% of all U.S. commercial paper outstanding as of April 2022.[105] Because of the strong connection between MMFs and the short-term funding markets, the health of MMF operations could affect businesses, government entities, households, and investors who rely on such markets.

In recent years, the MMF industry's assets increased, while the number of funds declined.[106] Government, prime (or corporate), and tax-exempt (or municipal) are the three main types of MMFs. These funds have different asset compositions and regulations. The MMF industry's net assets stood at $5.1 trillion as of July 2022. The industry's net assets have increased over time, especially after the COVID-19 pandemic when increases were led by government MMFs and only partially offset by decreases in prime and tax-exempt MMFs. Government MMFs held the most net assets ($4.1 trillion, or 80%, of the overall MMF industry assets), substantially more than prime MMFs ($917 billion, or 18%) and tax-exempt MMFs ($104 billion, or 2%).[107] Over the past decade, the number of MMFs decreased by nearly half, from 600 in October 2012 to 306 in July 2022.[108] Multiple reasons, including reduced fee income and increased operating costs, might have contributed to the decline in the number of MMFs.

Federal Securities Laws: An Overview, by Chris D. Linebaugh, Jay B. Sykes, and Nicole Vanatko.

[102] For details on these individual items, see CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su.

[103] For more on MMFs, see CRS Report R47309, *Money Market Mutual Funds: Policy Concerns and Reform Options*, by Eva Su.

[104] Federal Reserve Board, "Money Market Funds: Investment Holdings Detail," https://www.federalreserve.gov/releases/efa/efa-project-money-market-funds-investment-holdings-detail.htm.

[105] See Figure 2 of CRS Report R47309.

[106] See Figure 3 and Figure 4 of CRS Report R47309.

[107] SEC, Money Market Fund Statistics Form N-MFP Data, Period Ending July 2022, Filings Received Through August 12, 2022, August 15, 2022, https://www.sec.gov/files/mmf-statistics-2022-07.pdf.

[108] SEC, *Money Market Fund Statistics Form N-MFP Data*.

Despite perceptions of safety, MMFs both experienced and contributed to market disruptions in 2008 that accelerated the 2007-2009 financial crisis. At the time, the Treasury Department and the Federal Reserve developed multiple intervention tools to provide a backstop for the industry. Following the 2007-2009 crisis, the MMF industry underwent major regulatory reforms. During the 2020 COVID-induced market distress, however, some of the same MMF-related financial stability concerns recurred.[109] The federal government once again took action to mitigate the related risks.[110] These conditions have led to discussions about the effectiveness of previous MMF reforms and how policymakers could proceed with potential future reforms.

At the center of the MMF-related financial stability concern is MMFs' vulnerability to run risk. Run risk refers to the scenario where many investors withdraw their investments nearly simultaneously, triggering negative feedback loops and contagion effects for the broader financial system.[111] MMFs are susceptible to runs because their shareholders have an incentive to redeem their shares before others do when there is a perception that the fund might experience a loss (i.e., the first-mover advantage). The SEC published an MMF reform proposed rule in December 2021 that includes multiple options to address run risk.[112] Other financial authorities have also come up with additional proposals that are not part of the SEC's proposed amendments to MMF regulation. These proposals include[113]

- Rolling back some earlier reform provisions regarding *liquidity fees* and *redemption gates*;
- Addressing the first-mover advantage through *swing pricing* and *minimum balance at risk*;
- Increasing transparency through *additional disclosure requirements* and *floating NAV*;
- Addressing MMF liquidity needs through *increased liquidity requirements*; and
- Reducing MMF portfolio risks through mandatory sponsor support, a capital buffer, and limits on eligible assets.

SEC Proposed Rule

The SEC proposed amendments to its MMF rules on December 15, 2021.[114] The proposed amendments would increase liquidity requirements, require additional disclosures, and roll back some of the earlier reform provisions. In the SEC's view, the proposed reforms would reduce MMF investors' incentives to run.

---

[109] Antoine Bouveret, Antoine Martin, and Patrick McCabe, *Money Market Fund Vulnerabilities: A Global Perspective*, Federal Reserve, March 8, 2022, https://www.federalreserve.gov/econres/feds/files/2022012pap.pdf.

[110] Federal Reserve, "Money Market Mutual Fund Liquidity Facility," https://www.federalreserve.gov/monetarypolicy/mmlf.htm.

[111] For more on run risk, see Kenechukwu Anadu and Siobhan Sanders, "Money Market Mutual Funds: Runs, Emergency Liquidity Facilities, and Potential Reforms," Federal Reserve Bank of Boston, May 21, 2021, https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/2021/sra-note-2103.pdf.

[112] SEC, "Money Market Fund Reforms," 87 *Federal Register* 7248-7356, February 8, 2022.

[113] For a detailed explanation of each proposal, see CRS Report R47309.

[114] SEC, "SEC Proposes Amendments to Money Market Fund Rules," press release, December 15, 2021, https://www.sec.gov/news/press-release/2021-258; SEC, "Money Market Fund Reforms," 87 *Federal Register* 7248-7356, February 8, 2022.

For Further Information

For questions on MMFs, contact Eva Su, Analyst in Financial Economics.

Additional reading on MMFs, ETFs, and the asset management industry in general is available in:

CRS Report R47309, *Money Market Mutual Funds: Policy Concerns and Reform Options*, by Eva Su

CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su

CRS Report R45318, *Exchange-Traded Funds (ETFs): Issues for Congress*, by Eva Su

Policy Issue: Private Equity

Private equity (PE) is a type of *private* fund, meaning a fund that generally pools money from institutional and individual investors that meet certain criteria indicating they are sophisticated or able to withstand financial loss.[115] PE investors include pension funds, other private funds, university endowments, foreign institutions, high-net-worth individuals, insurance companies, and nonprofits.[116]

The term *private equity* can be used to describe a variety of funds. For example, some observers use the term to describe all types of private funds.[117] Others discuss PE as one type of fund within the broader categorization of private funds that also includes hedge funds, venture capital, and family offices. This report uses the terminology set forth by the SEC, which separates PE from other private fund types.[118] Under this definition, PE funds typically take a controlling interest in an operating business, also known as a *portfolio company*, and engage in financial and operational activities with the hope of increasing the company's value.[119] PE funds are known for active ownership, longer investment time horizons, and financial leverage through the use of debt. However, other PE investment and operational styles also exist.[120]

The PE industry has grown in size in recent years, including during the COVID-19 pandemic. According to the SEC, between the first quarter of 2016 and the second quarter of 2022, the number of PE funds nearly doubled to reach approximately 19,000.[121] Aggregate gross fund assets more than tripled to almost $6.4 trillion during that period.[122]

---

[115] For more on private equity, see CRS Report R47053, *Private Equity and Capital Markets Policy*, by Eva Su. For more on public and private funds, see CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su.

[116] SEC private funds statistics, https://www.sec.gov/divisions/investment/private-funds-statistics.

[117] For example, some experts define *private equity* as an alternative asset class that includes all assets beyond the three primary asset classes—stocks, bonds, and cash. For more details, see Benoit Leleux, Hans van Swaay, and Esmeralda Megally, *Private Equity 4.0: Reinventing Value Creation* (The Wiley Finance Series, 2015).

[118] SEC, Form PF—Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors, https://www.sec.gov/files/formpf.pdf.

[119] SEC, "Private Equity Funds," https://www.investor.gov/introduction-investing/investing-basics/investment-products/ private-investment-funds/private-equity.

[120] *Financial leverage* generally refers to the use of debt to buy more assets or fund existing operations. Other forms of leverage measures also exist. For more information, see Adam Hayes, "Leverage," Investopedia, March 19, 2021, https://www.investopedia.com/terms/l/leverage.asp.

[121] SEC, "Division of Investment Management Private Funds Statistics," https://www.sec.gov/divisions/investment/ private-funds-statistics.shtml.

[122] SEC, "Division of Investment Management Private Funds Statistics."

Some academic research has suggested that PE plays a role in enhancing competition, enabling capital formation, assisting distressed company resolution, and transforming financially underperforming companies.[123] The PE industry has also increased in importance because of the significant growth of private securities markets.[124]

Some observers have raised financial stability concerns in light of the PE industry's growth in size, importance, and complexity.[125] The PE industry has also generated policy debates regarding its performance record, operational practices, and industry-specific issues, including the compatibility of PE's profit maximization practices with certain public-service-oriented industries. Different aspects of PE's operating and financing model, which focuses on value creation for investors, attract policymakers' attention.[126] Below are some examples:

- **Capital restructuring.** PE funds sometimes restructure portfolio companies' debt and equity to manage the total cost of capital, draw down capital not yet invested, or negotiate with lenders to gain more flexibility for loans. Some observers view these activities as a way to extract wealth from portfolio companies while transferring risk to debt investors.[127] Other observers view excessive leverage (e.g., debt borrowing) as a financial stability concern because it could reduce the portfolio companies' ability to absorb risks during adverse market conditions.[128]
- **Operational changes.** PE firms may increase productivity through cutting jobs, selling non-core assets, or making adjustments to their portfolio companies' business strategies. Some observers argue that such practices enrich investors at the expense of affected individuals and communities.[129]

---

[123] See, for example, Steven J. Davis et al., *The (Heterogenous) Economic Effects of Private Equity Buyouts*, Harvard Business School, October 7, 2019, https://www.hbs.edu/ris/Publication%20Files/20-046_ceb00b98-e62a-45db-8d5f-9793ffd0226e.pdf; Emily Ross, Song Ma, and Manju Puri, *Private Equity and Financial Stability: Evidence from Failed Bank Resolution in the Crisis*, April 17, 2021, https://ssrn.com/abstract=3828789; and Edith Hotchkiss, Per Stromberg, and David Smith, *Private Equity and the Resolution of Financial Distress*, July 7, 2021, https://ssrn.com/abstract=1787446.

[124] Companies turn to capital markets to raise funding from investors. This process is referred to as a *securities offering*. Similar to public and private funds, *public* securities offerings are open to a wide range of investors and must meet comprehensive registration requirements imposed by the SEC, whereas *private* securities offerings are exempt from certain SEC registration requirements and face investor access restrictions. For more on public and private securities offerings and funds, see CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su; and CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[125] SEC Chair Gary Gensler, "Statement on Proposed Joint Amendment to Form PF," August 10, 2022, https://www.sec.gov/news/statement/gensler-statement-proposed-joint-amendments-form-pf-081022.

[126] See, for example, Sen. Elizabeth Warren, "Warren, Baldwin, Brown, Pocan, Jayapal, Colleagues Reintroduce Bold Legislation to Fundamentally Reform the Private Equity Industry," press release, October 20, 2021, https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-reintroduce-bold-legislation-to-fundamentally-reform-the-private-equity-industry.

[127] Adrian Blundell-Wignall, "The Private Equity Boom: Causes and Policy Issues," Organisation for Economic Co-operation and Development, 2007, https://www.oecd.org/daf/fin/financial-markets/40973739.pdf.

[128] For example, see background discussions in Sharjil Haque, "Do Private Equity Funds Over-Lever Portfolio Companies?," *Duke Financial Economics Center FinReg Blog*, September 13, 2021, https://sites.duke.edu/thefinregblog/2021/09/13/do-private-equity-funds-over-lever-portfolio-companies.

[129] U.S. Congress, House Committee on Financial Services, "America for Sale? An Examination of the Practices of Private Funds," hearing, 116th Cong., 1st sess., November 19, 2019, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404650.

- **Incentive allocation.** PE funds provide equity and other incentives for portfolio company managers and investment advisers managing the funds.[130] Some observers view certain investment fund manager incentives and fees as potentially excessive, non-transparent, and rife with conflict-of-interest concerns.[131]
- **Exit strategy.** PE firms exit their investments through mergers and acquisitions, initial public offerings, or secondary offerings to other PE firms. They may seek a partial exit through dividend recapitalizations, among other methods. Some observers are concerned about certain PE exit strategies, such as dividend recapitalizations, whereby portfolio companies borrow to pay dividends to equity investors.[132]

SEC Proposed Rules

The SEC published two proposed rules in the first quarter of 2022 to reform the PE industry through regulatory changes aimed at private fund advisers and Form PF disclosures.[133] These proposed amendments would generally affect all private funds, including PE. Many observers predict that these reforms would transform PE regulatory philosophy and practice. The SEC's proposed private fund reform focuses on investor protection issues,[134] and the Form PF reform emphasizes systemic risk mitigation and financial stability concerns.[135]

For Further Information

For questions about PE, contact Eva Su, Analyst in Financial Economics.

Additional reading on PE and the asset management industry in general is available in:

CRS Report R47053, *Private Equity and Capital Markets Policy*, by Eva Su

CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su

Investment Advisory Services

Individual investors often seek investment advice from financial professionals regarding asset allocation and securities transaction decisions. *Investment adviser* is a legal term that generally refers to an individual or company that is registered with the SEC and is paid by clients to provide

[130] Phillip Leslie and Paul Oyer, *Managerial Incentives and Value Creation: Evidence from Private Equity*, National Bureau of Economic Research, Working Paper no. 14331, September 2008, https://www.nber.org/papers/w14331.

[131] SEC, "Observations from Examinations of Investment Advisers Managing Private Funds," June 23, 2020, https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf.

[132] Matthew Goldstein, "Private Equity Firms Are Piling On Debt to Pay Dividends," *New York Times*, February 19, 2021, https://www.nytimes.com/2021/02/19/business/private-equity-dividend-loans.html.

[133] SEC, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," 87 *Federal Register* 16886-16977, March 24, 2022; and SEC, "Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers," 87 *Federal Register* 9106-9235, February 17, 2022.

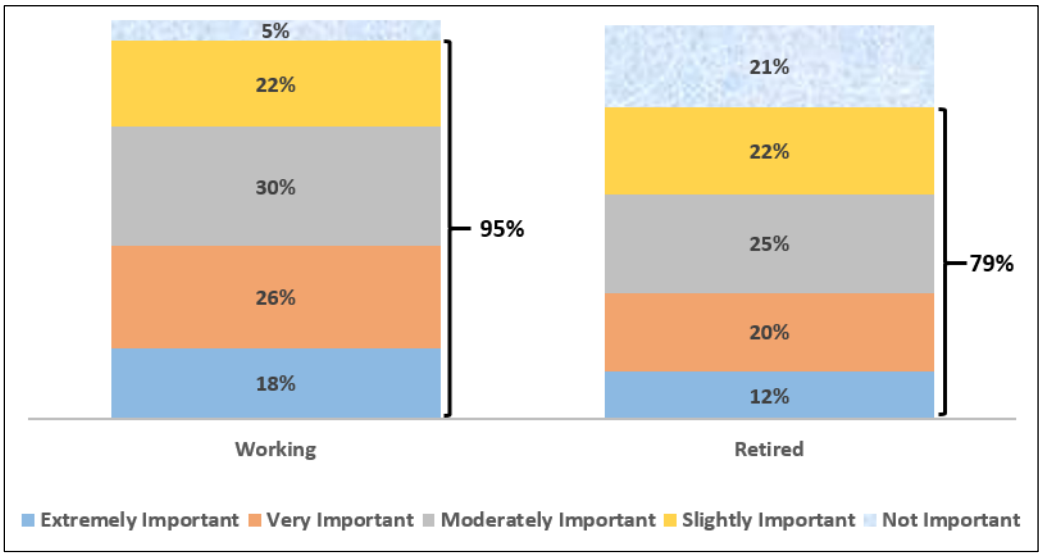
[134] SEC, "SEC Proposes to Enhance Private Fund Investor Protection," press release, February 9, 2022, https://www.sec.gov/news/press-release/2022-19.

[135] SEC, "SEC Proposes Amendments to Enhance Private Fund Reporting," press release, January 26, 2022, https://www.sec.gov/news/press-release/2022-9.

investment advice about securities transactions.[136] For example, asset managers, investment consultants, and financial planners are usually regulated in the United States as investment advisers under the Investment Advisors Act of 1940 (IAA; P.L. 76-768).[137] *Financial advisers*, or other similar professional titles, may more broadly include brokers. While financial professionals offering investment advisory services could hold different titles or register with different regulators in more than one capacity, the essence of their service would normally include helping clients with investment decisions.[138]

The investment advisory industry includes nearly 15,000 SEC-registered investment advisers managing $128 trillion in assets from 65 million clients.[139] The industry may also be growing in importance as a growing number of future retirees face difficulties meeting their financial needs. A 2022 industry survey shows that 51% of retired respondents' current income is less than half of their pre-retirement income.[140] Around 95% of working respondents and 79% of retired respondents view financial advice, counseling, and financial education as important (**Figure 5**).

Figure 5. The Importance of Financial Advice, Counseling, and Education



Source: CRS using data from Goldman Sachs.

Notes: Results from a survey of 1,566 individuals (967 working individuals and 599 retirees) who answered the survey question, "How important is it to receive financial help (education, advice, counseling) to successfully manage your retirement savings/income and investments?" For more details, see Goldman Sachs, "Retirement Survey and Insights Report 2022," October 12, 2022, p. 17, https://www.gsam.com/content/gsam/us/en/institutions/market-insights/gsam-insights/2022/retirement-survey-insights-2022.html.

[136] 15 U.S.C. §80b-2.

[137] SEC staff of the Investment Adviser Regulation Office, Division of Investment Management, *Regulation of Investment Advisors by the SEC*, March 2013, at https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

[138] SEC, *Making Sense of Financial Professional Titles*, https://www.sec.gov/files/ib_making_sense.pdf.

[139] Investment Adviser Association, *Investment Adviser Industry Snapshot 2022*, https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf.

[140] Goldman Sachs, "Retirement Survey and Insights Report 2022," October 12, 2022, https://www.gsam.com/content/gsam/us/en/institutions/market-insights/gsam-insights/2022/retirement-survey-insights-2022.html.

The way in which some financial services professionals are compensated may give rise to conflicts of interests if these professionals' recommendations result in larger commissions or otherwise benefit them.[141] These potential conflicts could lead the professionals to make recommendations that are not in the best interests of their clients. By contrast, some financial services professionals have compensation structures that do not vary based on which products clients choose. This type of compensation structure could help mitigate conflicts of interest.

A significant policy issue in investment adviser regulation is whether financial professionals are effectively mitigating conflict-of-interest concerns and appropriately prioritizing their clients' interests relative to their own. Although individual investors generally receive similar types of investment advisory services to help them meet their goals, their point of contact for accessing financial advice could be different. Some investors use investment management or brokerage firms, while others receive financial education and advice from retirement account providers retained by their employers. The SEC oversees registered investment advisors and broker-dealers (together with FINRA). The Department of Labor (DOL), on the other hand, oversees retirement accounts. Both agencies have established standards of care, described below, for mitigating conflicts of interest facing broker-dealers, investment firms, and providers of retirement accounts. This section discusses policy issues concerning these SEC and DOL initiatives.

Policy Issue: Broker-Dealers and Registered Investment Advisors—SEC Fiduciary and Best Interest Standards

As discussed above, broker-dealer firms or their affiliated persons act as brokers when they execute securities trades for their clients (and as dealers when they trade their own securities for their own benefit). They must register with the SEC[142] and must generally be members of and comply with the rules and guidance of FINRA.[143] In addition, broker-dealer sales personnel (called registered representatives) register with their state securities regulators.[144]

Broker-dealers were traditionally subject to what is known as the *suitability standard*, which required them to have a reasonable basis to believe that their recommendations are suitable for particular customers.[145] As of June 30, 2020, broker-dealers became subject to the newly implemented Regulation Best Interest (Reg BI), which requires a more enhanced standard of care for customers. (Reg BI is discussed in more detail below.)

Investment advisers include firms or persons who provide investment advice directly to their clients. Clients include individuals and institutional investors, such as mutual funds and hedge funds. Pursuant to the IAA, which regulates key aspects of the investment adviser industry, advisers with more than $110 million in assets under management must register with the SEC.[146]

---

[141] For example, because the commissions mutual funds pay can vary, financial professionals might have an incentive to recommend mutual funds that pay larger commissions.

[142] SEC, "Guide to Broker-Dealer Registration," https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html.

[143] SEC, "Guide to Broker-Dealer Registration."

[144] FINRA, "Brokers," https://www.finra.org/investors/brokers.

[145] FINRA, "Suitability," https://www.finra.org/rules-guidance/key-topics/suitability.

[146] *Assets under management* refers to the total market value of the financial assets managed on behalf of a client. The IAA regulates key aspects of investment advisers. For more information, see SEC, "The Laws That Govern the Securities Industry," https://www.sec.gov/Article/whatwedo.html#laws.

States generally register and regulate investment adviser firms with between $25 million and $110 million in assets under management.

Court rulings and SEC enforcement decisions have established that investment advisers owe fiduciary duties to their retail clients.[147] Under the *fiduciary standard*, advisers are generally required to subordinate their own interests to those of their clients. Advisers must also eliminate material conflicts of interest or disclose such conflicts. The fiduciary standard is thus more rigorous than was the historical suitability standard for broker-dealers.[148]

That disparity may, however, have been reduced when the SEC approved a new standard of client conduct and loyalty for broker-dealers known as Reg BI in June 2019. Reg BI went into effect in June 2020 and, according to SEC officials, established a more stringent regime of broker-dealer client conduct than did the suitability standard. Since Reg BI's adoption, there has been a policy debate over its merits. Proponents of Reg BI have argued that it reasonably reconciles the need for an enhanced broker-dealer standard of client care with the need to preserve the generally beneficial broker-dealer business model. Opponents, however, argue that the reform preserves what they view as the inadequate customer protections of the suitability standard.

The SEC's Regulation Best Interest Reform

On June 5, 2019, the SEC approved a package of final regulatory rules related to the duty of care financial professionals owe to retail investors (that went into effect on June 30, 2020).[149] The package involved both new rules and amendments under the IAA and the Securities Exchange Act of 1934. It contained (1) Reg BI, which established a "best interest" standard of conduct for broker-dealers who are giving securities recommendations to retail investors; (2) the Form Customer Relationship Summary (a short-form disclosure that would identify key distinctions in the types of services offered by broker-dealers and investment advisers to their clients, applicable legal standards, and potential conflicts of interest); (3) a clarification of the fiduciary duty owed by investment advisers to their clients under the IAA; and (4) an interpretation of the "solely incidental" broker-dealer exclusion under the IAA aimed at clarifying when a broker-dealer's exercise of investment advisory activities redefines it as an investment adviser under the IAA.[150]

Reg BI is meant to "enhance the broker-dealer standard of conduct beyond existing … obligations [by] requiring broker-dealers … to: (1) act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and (2) address [various broker-dealer] conflicts of interest" with those clients.[151]

The SEC and various business groups argued that Reg BI properly balances the need for an enhanced broker-dealer standard of care with the need to preserve the broker-dealer business

[147] For more details, see CRS Report R46115, *Regulation Best Interest (Reg BI): The SEC's Rule for Broker-Dealers*, by Gary Shorter.

[148] SEC, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, June 5, 2019, https://www.sec.gov/rules/interp/2019/ia-5248.pdf.

[149] SEC, "SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals," press release, June 5, 2019, https://www.sec.gov/news/press-release/2019-89. SEC, "Regulation Best Interest: The Broker-Dealer Standard of Conduct," 84 *Federal Register* 33318-33492, July 12, 2019.

[150] SEC, "SEC Adopts Rules and Interpretations."

[151] SEC, "Proposed Regulation Best Interest," *83 Federal Register* 21574, May 9, 2018.

model, a model deemed to have special appeal to less-affluent investors.[152] Critics have contended that the reform effectively preserves what they characterized as an inadequate suitability standard, exposing investors to harm from unaddressed broker-dealer conflicts of interest.[153] Some Members of Congress have thus proposed draft legislation to rescind Reg BI.[154]

Reg BI continued to face challenges after its implementation. A study released in November 2021 by the North American Securities Administrators Association, a group of state and provincial securities regulators, found that many broker-dealers were putting their own financial interests ahead of their retail customers in violation of Reg BI.[155] FINRA's February 2022 report on its first full year of assessing broker-dealer compliance with Reg BI found issues relating to procedures and compliance.[156] In September 2022, SEC officials reported that they expected to conduct broker-dealer examinations during the coming year to help the agency ascertain how well the industry had adapted to the Reg BI requirements.[157] Meanwhile, some have raised concerns that Reg BI gives some clients the false impression that brokers and investment advisers are interchangeable, notwithstanding the fact that only advisers owe fiduciary duties to their clients.[158]

For Further Information

For questions about SEC financial advice standards of care, contact Gary Shorter, Specialist in Financial Economics.

Additional reading on Regulation Best Interest is available in CRS Report R46115, *Regulation Best Interest (Reg BI): The SEC's Rule for Broker-Dealers*, by Gary Shorter.

---

[152] For example, see SEC, *Regulation Best Interest: The Broker-Dealer Standard of Conduct. Final Rule*, June 5, 2019, pp. 20-22, https://www.sec.gov/rules/final/2019/34-86031.pdf; and "Letter from Kenneth Bentsen, Jr., President and CEO of SIFMA, to Members of the U.S. House of Representatives Re: Waters Amendment #78 on Reg BI," June 25, 2019, https://www.sifma.org/resources/submissions/waters-amendment-78-on-reg-bi/.

[153] Statement by SEC Commissioner Robert J. Jackson, "Final Rules Governing Investment Advice," June 5, 2019, https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd; and Sarah O'Brien, "SEC's New Investor Protection Rule Won't End the Fiduciary Debate," CNBC, July 30, 2019, https://www.cnbc.com/2019/07/30/sec-new-investor-protection-rule-wont-end-the-fiduciary-debate.html.

[154] For example, on June 26, 2019, during the 116th Congress, the House passed H.R. 3351, the Financial Services and General Government Appropriations Act, 2020, which included appropriations for the SEC. The bill included an amendment sponsored by Chair Waters that said: "None of the funds made available by this Act may be used by the Securities and Exchange Commission to implement, administer, enforce, or publicize the final rules and interpretations of the Securities and Exchange Commission titled Regulation Best Interest: The Broker-Dealer Standard of Conduct." U.S. Congress, House Committee on Financial Services, "Dear President Elect Biden," December 4, 2020, https://financialservices.house.gov/uploadedfiles/120420_cmw_ltr_to_biden.pdf.

[155] North American Securities Administrators Association, *Report and Findings of NASAA's Regulation Best Interest Implementation Committee National Examination Initiative Phase II*, November 2021, https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf.

[156] FINRA, "2022 Report on FINRA's Examination and Risk Monitoring Program," February 9, 2022, https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program.

[157] Tracy Longo, "SEC Exams Will Focus on Reg-BI Compliance, Agency Officials Say," *FA Magazine*, September 9, 2022, https://www.fa-mag.com/news/sec-exams-will-focus-on-reg-bi-compliance—agency-officials-say-69612.html. On June 6, 2021, in its first Reg-BI-related enforcement, the SEC charged broker-dealer Western International Securities and five of its registered representatives and brokers with violating Reg BI when they recommended and sold an unrated, high-risk debt security known as L Bonds to retirees and other retail investors. SEC, "SEC Charges Firm and Five Brokers with Violations of Reg BI," press release, June 6, 2021, https://www.sec.gov/news/press-release/2022-110.

[158] Longo, "SEC Exams Will Focus on Reg-BI Compliance."

Policy Issue: Pension and Retirement Accounts—DOL Fiduciary Standards

A pension is a voluntary benefit offered by employers to assist employees in providing for their financial security in retirement.[159] The two types of pension plans that employers can offer are defined contribution (DC) plans, in which participants have individual accounts that can provide income in retirement, and defined benefit (DB) plans, in which participants receive regular monthly benefit payments in retirement (which some refer to as a "traditional" type of pension).[160]

Some employers sponsor both types of pension plans for their employees, though most sponsor either one type or the other.[161] Most private sector employers that sponsor pension plans offer DC plans, of which the 401(k) plan is the most common. Pension discussions also frequently include Individual Retirement Accounts (IRAs), which are tax-advantaged accounts for individuals to save for retirement outside of employer-sponsored plans. Often, individuals who have savings in DC plans or receive lump sum payments from DB plans roll over their savings to IRAs at job change or retirement.

Retirement plans are complex, and both employers and plan participants often rely on financial services professionals to assist them with their decisionmaking. For example, an employer might seek assistance in determining which investments to offer in a DC plan it has established. A participant in a DC plan might seek assistance in choosing investments from among the options offered by the plan or advice on whether to roll over a 401(k) balance into an IRA or another employer's DC plan upon job change or retirement.

To protect the financial interests of private sector pension plan participants and beneficiaries, Congress passed the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406). ERISA is codified in the *U.S. Code* in Title 26 (Internal Revenue Code) and Title 29 (Labor Code). Individuals who transact with pension plans may be required to meet certain standards as found in pensions and securities laws and regulations. The standard that applies depends on the individuals' roles and the actions they are taking.

Fiduciary Duty Under ERISA

ERISA Section 3(21)(A) provides that a person is a fiduciary to the extent that the person:

- exercises any discretionary authority or control with respect to the management of the plan or exercises any authority with respect to the management or disposition of plan assets,
- renders investment advice for a fee or other compensation with respect to any plan asset or has any authority or responsibility to do so, or

[159] For an overview of pensions, see CRS Report R47119, *Pensions and Individual Retirement Accounts (IRAs): An Overview*, coordinated by Elizabeth A. Myers.

[160] In some DC plans, plan participants have the option to purchase annuities (a monthly payment for life) with some or all of their account balances. In some DB plans, plan participants have the option to receive a lump-sum payment at retirement in lieu of the annuity.

[161] In March 2021, 12% of private sector workers had access to both DB and DC plans, 3% had access to DB plans only, and 53% had access to DC plans only. See DOL, *National Compensation Survey: Employee Benefits in the United States, March 2021*, September 2021, https://www.bls.gov/ncs/ebs/benefits/2021/employee-benefits-in-the-united-states-march-2021.pdf.

- has any discretionary responsibility in the administration of the plan.[162]

An individual who is a fiduciary is required, among other duties, to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries."[163] ERISA identifies four standards of conduct: (1) a duty of loyalty, (2) a duty of prudence, (3) a duty to diversify investments, and (4) a duty to follow plan documents to the extent that they comply with ERISA.[164]

ERISA Section 3(21)(a) governs the circumstances in which a person qualifies as a fiduciary. One of these circumstances, in which an individual renders investment advice for a fee or other compensation, is the subject of a 1975 DOL regulation that created a five-part test to determine whether an individual provided investment advice and thus was subject to the fiduciary standard.[165]

To be held to the 1975 fiduciary standard with respect to his or her advice, each of the following five elements must hold: (1) an individual must make recommendations on investing in, purchasing, or selling securities or other property or give advice as to the value, and the recommendations must (2) be made on a regular basis, (3) be pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions and (5) be individualized to the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments. An investment professional is not treated as a fiduciary unless each of the five elements of the test is satisfied for each instance of advice.

In December 2020, DOL issued a prohibited transaction exemption (PTE 2020-02) to ensure that fiduciaries, such as financial institutions and investment professionals, can continue to receive compensation, such as commissions, that would otherwise be prohibited.[166] In addition, PTE 2020-02 noted that recommendations about whether to roll over balances from pension plans to IRAs could be investment advice if the relationship between the advisor and client was, or was

[162] See ERISA §3(21)(A).

[163] ERISA §404(a).

[164] ERISA §§404(a)(1)(A)-404(a)(1)(D). For more information on a fiduciary's duty to monitor a plan's investments, see CRS Legal Sidebar LSB10636, *Supreme Court Rules on Retirement Plan Fiduciary Duty in Hughes v. Northwestern University*.

[165] In 2016, DOL issued a rule that replaced the five-part test with a broader definition of *investment advice*. The rationale for the rule included the inadequacy of the existing rule to address DC plans, which an increasing number of workers have had since the 1975 test was issued, and the enforcement challenges DOL had with demonstrating that an individual met each element of the five-part test. See DOL, *Regulating Advice Markets*, April 2016, https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/ria.pdf. However, the 2016 rule was vacated by the courts and the five-part test was restored. See Employee Benefits Security Administration, "Conflict of Interest Rule—Retirement Investment Advice: Notice of Court Vacatur," 85 *Federal Register* 40589-40594, July 7, 2020, https://www.govinfo.gov/content/pkg/FR-2020-07-07/pdf/2020-14260.pdf; and Employee Benefits Security Administration, "Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers and Retirees," 85 *Federal Register* 82798-82866, https://www.govinfo.gov/content/pkg/FR-2020-12-18/pdf/2020-27825.pdf.

[166] An investment advice fiduciary would generally be unable to receive compensation, such as commissions, if the compensation varied based on the investment recommendations. See Employee Benefits Security Administration, "Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers and Retirees," 85 *Federal Register* 82798-82866, https://www.govinfo.gov/content/pkg/FR-2020-12-18/pdf/2020-27825.pdf.

expected to be, ongoing.[167] The best interest standard in PTE 2020-02 is "broadly aligned" with the SEC's Reg BI standards.[168]

In its Spring 2022 Regulatory Agenda, DOL indicated that it would amend the definition of *fiduciary* "to take into account practices of investment advisers, and the expectations of plan officials and participants, and IRA owners who receive investment advice, as well as developments in the investment marketplace."[169]

For Further Information

For questions about DOL fiduciary standard, contact John Topoleski, Specialist in Income Security.

Additional reading on DOL fiduciary standards for investment advice is available in:

CRS Report R44884, *Department of Labor's 2016 Fiduciary Rule: Background and Issues*, by John J. Topoleski and Gary Shorter

CRS In Focus IF10686, *DOL's 2016 Fiduciary Rule on Investment Advice*, by John J. Topoleski

Environmental, Social, and Governance (ESG) Investing

ESG investing refers to an investment process that incorporates environmental, social, and governance factors into asset allocation and risk-taking decisions that are often aligned with social values, sustainability, and climate-related objectives.[170] The emergence of the ESG trend corresponded to increased inquiries by investors, policymakers, and civil society stakeholders toward sustainable finance and tailored financial products that are more reflective of ESG goals.

Global institutional investors indicate in at least one survey that they are receptive to ESG investing. Around 90% of global investors surveyed by a large asset manager indicated that they either found the ESG strategy central to their investment approaches or have considered or applied ESG investing as part of their investment approaches (**Figure 6**). As shown by the survey, Europe leads the ESG investing adoption rate globally. In North America, 18% of the respondents say that ESG is central to their investment approaches, 30% of the respondents apply ESG investing in their investment approaches, and 31% of the respondents are considering ESG.

[167] See Employee Benefits Security Administration, *New Fiduciary Advice Exemption: PTE 2020-02 Improving Investment Advice for Workers and Retirees Frequently Asked Questions*, April 2021, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption.

[168] See DOL, Employee Benefits Security Administration, "Prohibited Transaction Exemption 2020-02, Improving Investment Advice for Workers & Retirees," 85 *Federal Register* 82801, December 18, 2020; and SEC, *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, June 5, 2019, https://www.sec.gov/rules/interp/2019/ia-5248.pdf.

[169] See RIN: 1210-AC02, Definition of the term "Fiduciary," https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202204&RIN=1210-AC02.

[170] Organisation for Economic Co-operation and Development, *ESG Investing: Practices, Progress and Challenges*, 2020, http://www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf.

Figure 6. Global ESG Investing Adoption Levels

Source: Capital Group.

Notes: Results from a survey of 1,130 global institutional investors (conducted between February and March 2022) who answered the question, "Which of the following statements best describes your organization's overall stance on ESG investing? (Select one answer.)" Data may not equal 100% due to rounding. For more details, see Capital Group, *ESG Global Study 2022*, https://www.capitalgroup.com/advisor/pdf/shareholder/ITGEOT-028-658081.pdf.

Many policy debates surrounding ESG investing center around SEC actions that established new ESG-specific mandatory compliance frameworks for issuers and funds for the first time. Affected stakeholders are sharing their perspectives about the potential impact of these new regulatory frameworks. This section covers the SEC's proposed climate disclosure rule and investment management company ESG compliance requirements in more detail.

Policy Issue: The SEC's Proposed Climate Disclosure Rule

In light of public concern over climate change, some stakeholders have asked to what extent publicly traded companies should disclose their climate-related risks. The SEC requires publicly traded companies to disclose financial statements and certain other relevant business information in public filings, including annual and quarterly reports. While current SEC requirements do not address climate-related risks expressly, publicly traded companies must disclose such risks if they are "material" under federal securities laws.[171]

Numerous organizations, shareholder groups, businesses, and financial regulators have recognized financial risks that climate change may pose to companies. Such climate-related risks commonly fall into two general categories:

Physical risks: These risks include direct and indirect risks arising from extreme weather events and from longer-term shifts in climate patterns, including, for example, changes in water availability and food security. Physical risks have important implications for many companies' physical facilities, operations, transportation costs, supply chains, and employees.

[171] In *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), the Supreme Court explained that a fact is "material" if there is a "substantial likelihood" that a reasonable shareholder would find its omission to alter the total mix of available information significantly.

Transition risks: These risks arise from policy, legal, technology, and market changes as the world transitions to a lower-carbon economy, with potential financial or reputational effects on businesses. For example, a company may engage in efforts to reduce greenhouse gas (GHG) emissions or otherwise respond to changing consumer behavior.[172]

Although financial regulators have not traditionally focused on climate change, some financial regulators, including the SEC, have begun to consider the economic impact of climate-related changes and published proposals to address climate-related risks.[173]

SEC Proposed Rule

On March 21, 2022, the SEC proposed climate-related disclosure rules for public companies.[174] The proposal represents a more prescriptive and detailed approach to climate-related disclosures relative to the existing broad, principles-based climate-related disclosure regime embodied in the SEC's 2010 "Guidance Regarding Disclosure Related to Climate Change."[175] Among other things, it would require all public companies, as a growing number voluntarily do, to report on their direct GHG emissions and under certain circumstances their upstream and downstream GHG emissions. If adopted, the disclosure requirements would direct domestic or foreign SEC registrants to include climate-related information in their registration statements, such as Form S-1, and their periodic reports, such as Form 10-K. The proposed disclosures can be divided into four broad types: climate-related risks, GHG emissions, targets and goals, and audited financial statement disclosures.

Public companies would also be required to report on the impacts of climate-related natural events and transitional activities to mitigate such impacts on their consolidated financial statements. According to the SEC, both the current and proposed disclosure regimes are grounded in the federal securities laws' concept of *materiality*—the notion that required disclosures should encompass the types of information that investors consider important when they make investment or corporate voting decisions.[176]

Some SEC commissioners say that the current voluntary reporting protocol has often resulted in incomplete and inconsistent significant climate-related disclosures due to differences in

---

[172] For more on climate-related risk drivers, see Basel Committee on Banking Supervision, *Climate-Related Risk Drivers and Their Transmission Channels*, April 2021, https://www.bis.org/bcbs/publ/d517.pdf.

[173] See CRS In Focus IF11307, *Climate-Related Risk Disclosure Under U.S. Securities Laws*, by Eva Su and Nicole Vanatko.

[174] SEC, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," 87 *Federal Register* 21334-21473, April 11, 2022. The timeline for finalizing the rule has faced delays, and the SEC is reportedly considering the options to scale back the proposal. Declan Harty, "SEC's Gensler Weighs Scaling Back Climate Rule as Lawsuits Loom," *Politico*, February 4, 2023, https://www.politico.com/news/2023/02/04/sec-climate-rule-scale-back-00081181.

[175] SEC, "Commission Guidance Regarding Disclosure Related to Climate Change," 75 *Federal Register* 6289-6297, February 8, 2010.

[176] For example, SEC Chair Gary Gensler noted, "In making decisions about disclosure requirements under the federal securities laws—including decisions about today's climate-related disclosures—I am guided by the concept of materiality. As the Supreme Court has explained, information is material if 'there is a substantial likelihood that a reasonable shareholder would consider it important' in making an investment or voting decision, or if it would have 'significantly altered the total mix of information made available.'" SEC Chair Gary Gensler, "Statement on Proposed Mandatory Climate Risk Disclosures," March 21, 2022, https://www.sec.gov/news/statement/gensler-climate-disclosure-20220321. SEC, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," 87 *Federal Register* 21334-21473, April 11, 2022.

methodology and in assessing what is material.[177] Various investors and observers have said that these shortcomings have compromised the complete disclosure of the financial risks related to climate change.[178] Further, according to some SEC officials, the proposed rules are aimed at addressing such perceived drawbacks of the voluntary framework.[179]

Other SEC commissioners, however, have argued that the current reporting protocol has generally resulted in firms consistently reporting materially significant climate-related impacts.[180] They also asserted that the proposed rules go beyond the SEC's statutory authority, will not result in consistent and comparable inter-firm reporting due to unreliable data and modeling based on potentially speculative assumptions, and discard the materiality qualifier for some disclosures while employing an overly expansive definition of *materiality* for others.[181]

At the time of the vote, SEC Chair Gary Gensler remarked, "Today's proposal would help issuers more efficiently and effectively disclose [climate risks] … and meet investor demand, as many issuers already seek to do."[182] Some environmental groups have supported such measures based on similar arguments. For example, the Environmental Defense Fund said that, if finalized, the rules would "help investors price climate risks accurately and allocate capital prudently and efficiently through access to comparable specific, and decision-useful climate risk information."[183]

Echoing a common criticism of the proposal, the U.S. Chamber of Commerce asserted that "the prescriptive approach taken by the SEC will limit companies' ability to provide information that shareholders and stakeholders find meaningful while at the same time requiring that companies provide information in securities filings that are not material to investors."[184]

Climate-related risks. The proposal includes a number of provisions that involve nonfinancial disclosures surrounding corporate climate-related risks. They are modeled in part after the recommendations of the Task Force for Climate-Related Disclosures—a group of financial experts created by the Financial Stability Board.[185] They also draw from the Greenhouse Gas

[177] See, for example, SEC Commissioner Allison Herren Lee, "A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC," March 15, 2021, https://www.sec.gov/news/speech/lee-climate-change.

[178] See, for example, testimony of Steven M. Rothstein, Managing Director, Ceres Accelerator for Sustainable Capital Markets, in U.S. Congress, Senate Climate Change Task Force, August 2, 2022, https://www.ceres.org/news-center/blog/congressional-testimony-climate-disclosure-financial-disclosure.

[179] See, for example, Herren Lee, "A Climate for Change."

[180] See, for example, SEC Commissioner Hester M. Peirce, "We Are Not the Securities and Environment Commission—At Least Not Yet," March 21, 2022, https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321.

[181] Peirce, "We Are Not the Securities and Environment Commission."

[182] Gensler, "Statement on Proposed Mandatory Climate Risk Disclosures."

[183] Environmental Defense Fund, "Unpacking the Proposed SEC Rule on Climate Risk Disclosure," https://business.edf.org/insights/unpacking-the-proposed-sec-rule-on-climate-risk-disclosure/.

[184] U.S. Chamber of Commerce, "U.S. Chamber Voices Concern with Prescriptive Approach of SEC Climate Disclosures Proposal, Will Work with SEC to Develop Clear and Workable Rules," March 21, 2022, https://www.uschamber.com/finance/corporate-governance/u-s-chamber-voices-concern-with-prescriptive-approach-of-sec-climate-disclosures-proposal-will-work-with-sec-to-develop-clear-and-workable-rules.

[185] Task Force on Climate-Related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures*, June 15, 2017, https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.

Protocol, a global initiative that provides standards for business and government to monitor GHG emissions.[186] These provisions would require a covered company to disclose:

- a description of its climate-related risks and relevant risk management processes;
- how identified climate-related risks have had or are likely to have a material impact on its business and financial statements during the short, medium, or long term;
- how identified climate-related risks have affected or are likely to affect its strategy, business model, capital allocation, financial planning, and outlook;
- how climate-related events (including severe weather events and other natural conditions) and transition activities (to help mitigate or adapt to climate-related risks) would impact the line items of its consolidated financial statements, as well as the financial estimates and assumptions used in the statements;
- its estimated cost of carbon emissions (if it uses an internal carbon price) and information about that estimate and how it is formulated; and
- information that enables investors to understand those aspects of its climate risk management strategy (if the firm has undertaken scenario analysis, developed transition plans, or publicly issued climate-related targets or goals).[187]

GHGs. Under the proposal, firms would generally be required to disclose their direct GHG emissions from operations that they own or control (Scope 1 emissions) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2). They would also be required to describe the methodology, significant inputs, and assumptions used for their calculations. For both, the disaggregated constituent GHG emissions would also have to be disclosed.[188]

Firms would also be required to disclose their Scope 3 emissions if they deem them material or have established GHG emissions targets or goals. Scope 3 emissions are a consequence of a firm's activities but derive from its upstream and downstream activities, which may be neither owned nor controlled by it. Examples of Scope 3 emissions include emissions associated with the production and transportation of goods, purchases from third parties, employee commuting or business travel, waste generation, the processing or use of the registrant's products by third parties, the processing of sold products, the use of sold products, franchises, and investments. The required reporting of Scope 3 emissions has been one of the most significant aspects of the proposal.

The proposal provides for a "safe harbor" that would shield firms from legal liability under the federal securities laws for their Scope 3 reporting if done in good faith. It would also exempt smaller reporting companies from Scope 3 disclosure requirements.

Targets and goals. If a firm has publicly established climate-related targets or goals, the proposal would require it to disclose a number of related items. Among them are (1) the scope and time horizon for the targeted activities and emissions, (2) how the targets will be met, and (3) data that tracks progress toward the goals.[189]

---

[186] Greenhouse Gas Protocol, "Standards," https://ghgprotocol.org/standards.

[187] SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Release Nos. 33-11042, 34-94478, File No. S7-10-22 (Mar. 21, 2022), p. 42, https://www.sec.gov/rules/proposed/2022/33-11042.pdf.

[188] SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, p. 147.

[189] SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, p. 266.

For Further Information

For questions about climate disclosure and climate-related financial risk, contact Rena Miller, Specialist in Financial Economics, or Gary Shorter, Specialist in Financial Economics.

For questions about SEC disclosure in general, contact Eva Su, Analyst in Financial Economics.

Additional reading on climate disclosure and the SEC disclosure requirements is available in:

CRS Report R46766, *Climate Change Risk Disclosures and the Securities and Exchange Commission*, by Rena S. Miller, Gary Shorter, and Nicole Vanatko

CRS In Focus IF12108, *Overview of the SEC Climate Risk Disclosure Proposed Rule*, by Gary Shorter and Rena S. Miller

CRS In Focus IF11307, *Climate-Related Risk Disclosure Under U.S. Securities Laws*, by Eva Su and Nicole Vanatko

CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su

Policy Issue: Investment Manager ESG Compliance

ESG funds are funds that consider ESG factors in investment decisionmaking. Investor interest in such funds has grown considerably over the years. For example, according to Morningstar, which tracks fund data, domestic ESG funds had $357 billion in assets at the end of 2021, more than four times the total amount held three years earlier.[190] ESG funds' increased popularity indicates that they may have fulfilled an apparent investor demand.

Although ESG funds provide investors with opportunities to align their investments with personal values and expected long-term returns, they face challenges regarding their lacking of clarity about what the funds are actually doing. One example relates to the existence of "greenwashing," a form of company or fund operations that market their products or brand under the label of "green" or ESG without substantive efforts to ensure the related outcome, thus overstating their ESG impact while potentially misleading investors and the public.[191]

For years, various outside observers and some SEC officials raised concerns over allegedly confusing relationships between some fund names, especially environmentally oriented ones, and the fund investment strategies.[192] Fund names are largely governed by the "Names Rule" (Rule 35d-1 pursuant to the Investment Company Act) adopted by the SEC in 2001. Rule 35d-1 requires that at least 80% of the assets of certain funds with a name suggesting a focus on particular types of investment (e.g., industries, nations, regions) must be invested in those types of assets.

---

[190] Andrew Shilling, "This Is the Best-Performing Sustainable Fund over the Past 5 Years—and It Had a Return of More Than 30%," *Market Watch*, October 1, 2022, https://www.marketwatch.com/picks/this-is-the-best-performing-major-sustainable-fund-over-the-past-5-years-and-it-had-a-return-of-more-than-30-01664391557.

[191] For more on greenwashing, see KPMG, "ESG: Addressing Greenwashing in Financial Services," 2022, https://home.kpmg/xx/en/home/insights/2022/04/esg-addressing-greenwashing-in-financial-services.html.

[192] For example, see SEC Commissioner Elad Roisman, "Keynote Speech at the Society for Corporate Governance National Conference," July 7, 2020, https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020; SEC Chair Gary Gensler, "Prepared Remarks Before the Asset Management Advisory Committee," July 7, 2021, https://www.sec.gov/news/speech/gensler-amac-2021-07-07; and Mariana Lemann, "Regulators Put ESG Fund Names Under the Microscope," *Financial Times*, October 17, 2021, https://www.ft.com/content/126c9502-9400-4bac-a073-2d76ef2f55a7.

According to some reports, the SEC staff has often taken the position that terms such as *ESG* or *sustainable* in a fund name trigger the rule's requirement.[193]

Responding to changing conditions surrounding the industry, on May 25, 2022, the SEC proposed two rules to amend how investment fund names are governed and to enhance ESG fund disclosure. These proposals have generated debate. This section explains both proposals.

SEC Proposed Rule on Fund Names

On May 25, 2022, the SEC commissioners proposed amendments to its "Names Rule" governing certain investment fund names. If adopted as proposed, the reform would require SEC-registered funds to reassess their fund names, investment policies mandated under the Names Rule, and related fund prospectus disclosures. Major parts of the proposal include rules that would (1) expand the 80% investment requirement to any fund whose name suggests a focus on particular characteristics, such as ESG factors; (2) require a fund to use a derivatives instrument's notional amount, rather than its market value, to determine the fund's compliance with the 80% requirement; (3) allow for temporary departures from the 80% requirement, such as during sudden changes in the market value of a fund's underlying investments; (4) prohibit a registered closed-end fund or a business development company whose shares are not listed on a national securities exchange from changing its 80% investment policy unless fund shareholders vote to do so; (5) provide enhanced information to investors and the SEC on how fund names track a fund's investments; and (6) prohibit integration funds—a type of fund that considers ESG factors alongside but not more than other non-ESG factors—from using ESG or similar terminology in its name.[194]

SEC Proposed Rule on Investment Manager ESG Disclosure

The SEC does not have rules that specifically govern ESG disclosures. Rather, the SEC has explained that different funds and advisers have adopted varying definitions of ESG investing. The commission has argued that the absence of a common ESG disclosure framework makes it difficult for investors to understand the investment policies behind particular ESG strategies.[195]

Based on these concerns, the SEC issued a proposed rule in May 2022 that would mandate various disclosures for certain investment companies and investment advisers that purport to employ ESG strategies.[196] The proposed rule would direct funds and investment advisors that claim to incorporate one or more ESG factors to disclose (1) how ESG factors play a role in their portfolio investment selection procedures and (2) how ESG factors are integrated into their investment strategies.[197]

For Further Information

For questions on investment manager ESG compliance, contact Gary Shorter, Specialist in Financial Economics.

---

[193] Jacob Wolinsky, "How ESG Funds Will Be Impacted by the SEC's Expansion of the 80 Percent Names Rule," *Forbes*, October 6, 2022, https://www.forbes.com/sites/jacobwolinsky/2022/10/06/how-esg-funds-will-be-impacted-by-the-secs-expansion-of-the-80-percent-names-rule.

[194] SEC, "Amendments to the Fund 'Names Rule,'" May 25, 2022, https://www.sec.gov/files/ic-34593-fact-sheet.pdf.

[195] SEC, "ESG Disclosures for Investment Advisers and Investment Companies," May 25, 2022, https://www.sec.gov/files/ia-6034-fact-sheet.pdf.

[196] SEC, "Investment Company Names," 87 *Federal Register* 36594-36651, June 17, 2022.

[197] SEC, "ESG Disclosures for Investment Advisers and Investment Companies."

Additional reading on ESG names rule and investment manager ESG disclosure is available in:

CRS In Focus IF12226, *Environmental, Social, and Governance Funds: SEC Proposed Names Rule Reform*, by Gary Shorter

CRS In Focus IF12228, *Environmental, Social and Governance Funds: SEC-Proposed Disclosure Reform*, by Gary Shorter

CRS In Focus IF11716, *Introduction to Financial Services: Environmental, Social, and Governance (ESG) Issues*, by Raj Gnanarajah and Gary Shorter

Digital Assets

In recent years, financial innovation in capital markets has fostered a new asset class—digital assets—and introduced new forms of fundraising and trading. The Infrastructure Investment and Jobs Act defines *digital asset* as any digital representation of value that is recorded on a cryptographically secured distributed ledger technology (DLT) or any similar technology as specified by the Treasury Secretary.[198] Sometimes, the term *digital asset* has been used interchangeably to refer to *crypto-assets*, *cryptocurrencies*,[199] or *digital tokens*.[200] Some financial authorities separate crypto-assets from digital assets, using the term *digital asset* to refer to two categories of products—crypto-asset and central bank digital currency.[201] This section follows this terminology by using *crypto-asset* generally to describe private sector digital assets that are enabled using cryptography and DLT.[202]

The crypto-asset market includes around 10,000 tokens totaling around $1 trillion as of October 2022.[203] The two largest tokens—Bitcoin and Ether—represent more than half of the total value.[204] At the previous market peak in November 2021, the market capitalization of all cryptocurrencies reached $3 trillion.

Crypto-assets generally face higher risk and price volatility than traditional assets do. Some crypto-asset risk factors are commonly seen in the traditional financial world (e.g., credit, market, operational, and systemic risks), while others are more amplified because of the nature of crypto operations (e.g., cybersecurity, illicit activities, and market transparency). Some observers believe that digital assets have already experienced more substantial price volatility relative to other asset classes that emerged during the past 50 years.[205]

Institutional investors, who are perceived as more sophisticated and more able to dedicate resources toward investment research, have shown increased interest in crypto-assets in recent

[198] P.L. 117-58. "Except as otherwise provided by the Secretary, the term 'digital asset' means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary."

[199] For more on cryptocurrency, see CRS Report R47425, *Cryptocurrency: Selected Policy Issues*, by Paul Tierno.

[200] Board of the International Organization of Securities Commissions, *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms*, May 2019, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD627.pdf.

[201] Financial Stability Oversight Council, *Report on Digital Asset Financial Stability Risks and Regulation*, 2022, https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf.

[202] For more on blockchain and DLT, see CRS Report R47064, *Blockchain: Novel Provenance Applications*, by Kristen E. Busch.

[203] CoinMarketCap, "Global Crypto Currency Charts," https://coinmarketcap.com/charts.

[204] CoinMarketCap, "Today's Cryptocurrency Prices by Market Cap," https://coinmarketcap.com.

[205] J. P. Morgan Global Research, *Digital Transformation and the Rise of Fintech: Blockchain, Bitcoin and Digital Finance 2021*, February 18, 2021, p. 23, https://www.tbstat.com/wp/uploads/2021/02/JPM_Bitcoin_Report.pdf.

years. The factors that have previously discouraged institutional investors from investing in crypto-assets reportedly include market manipulation, price volatility, valuation challenges, cybersecurity, and regulatory uncertainty surrounding SEC securities regulation.[206]

The $1 trillion crypto-asset market is a fraction of the $100 trillion traditional capital markets, but events in the crypto market have the potential to amplify shocks and create disruptions in interrelated parts of the financial system. Financial regulators, including the SEC, have identified the need to monitor market developments comprehensively and mitigate potential risks to investors and the financial system.

Policy Issue: SEC Digital Asset Jurisdiction

The current regulatory landscape for digital assets (or crypto-assets) is fragmented. Multiple agencies apply different regulatory approaches to crypto-assets at the federal and state levels. For example, the SEC treats some crypto-assets as "securities," and the CFTC treats some crypto-assets as "commodities."[207] State regulators oversee crypto-asset exchanges through state money transfer laws, and the Treasury Department's Financial Crimes Enforcement Network monitors them for anti-money laundering purposes.

Crypto-assets have a growing presence in the financial services industry. Their increasing use in capital markets raises policy questions regarding whether changes to existing laws and regulations are warranted and, if so, when such changes should happen, what form they should take, and which agencies should take the lead.

In general, during policy considerations, investor protection and market integrity concerns should be balanced with the need to foster financial innovation. Some believe that certain crypto-asset activities that may appear similar to traditional activities nonetheless require adjusted regulatory approaches to account for particular operating models that may amplify risks differently.[208] Others believe that many crypto firms are replicating features of the traditional financial system and should be treated in the same manner as traditional institutions that perform similar functions.[209] Policymakers generally contending with major financial innovations have historically focused on addressing risk concerns while ensuring that regulations are sufficiently flexible to accommodate evolving technology.[210]

---

[206] Fidelity Digital Assets, *Institutional Investor Digital Assets Study: Key Findings*, October, 2022, https://www.fidelitydigitalassets.com/sites/default/files/documents/2022_Institutional_Investor_Digital_Assets_Study.pdf.

[207] The CFTC has taken the position that many cryptocurrencies qualify as commodities under the Commodity Exchange Act (P.L. 93-463). The agency has pursued several enforcement actions involving cryptocurrencies using its authority over fraud and manipulation in interstate commodity spot markets. CFTC, *Customer Advisory: Understand the Risks of Virtual Currency Trading*, https://www.cftc.gov/sites/default/files/idc/groups/public/@customerprotection/documents/file/customeradvisory_urvct121517.pdf. For more information, see CRS Legal Sidebar LSB10227, *CFTC and Virtual Currencies: New Court Rulings and Implications for Congress*, by Nicole Vanatko.

[208] For example, Coinbase, *Digital Asset Policy Proposal*, October 24, 2021, https://assets.ctfassets.net/c5bd0wqjc7v0/7FhSemtQvq4P4yS7sJCKMj/a98939d651d7ee24a56a897e2d37ef30/coinbase-digital-asset-policy-proposal.pdf.

[209] For example, Huw Jones, "Global Regulators Back 'Same Risk, Same Regulation' for Stablecoins," Reuters, July 13, 2022, https://www.reuters.com/technology/global-regulators-back-same-risk-same-regulation-stablecoins-2022-07-13.

[210] One example is the evolution of the equity market structure, which went from pen and paper to high-frequency trading, and the regulatory changes along the way. For more details, see SEC Historical Society, *Transformation and Regulation: Equities Market Structure, 1934 to 2018*, https://www.sechistorical.org/museum/galleries/msr.

SEC and CFTC Jurisdiction

The SEC is the primary regulator overseeing securities offers, sales, and investment activities, including those involving crypto-assets. When a crypto-asset meets the criteria defining a security,[211] it is subject to securities regulation, per existing SEC jurisdiction. SEC Chair Gary Gensler has repeatedly stated that the vast majority of crypto tokens are securities, while some crypto-assets are not.[212] Other stakeholders, including the crypto industry, disagree with that assertion.[213]

Crypto-assets may also be commodities under the Commodity Exchange Act (P.L. 74-675). In such cases, they are subject to the CFTC's jurisdiction, which generally extends to commodities and derivatives.[214] For example, under this framework, most initial coin offerings are considered securities,[215] but Bitcoin is considered a commodity, not a security.[216] Securities regulations could also apply if crypto market intermediaries (e.g., investment advisers, trading platforms, and custodians) are directly engaged in the security-based crypto-asset transactions.[217]

For crypto-assets that are securities, the SEC has both (1) *enforcement* authority that allows it to bring civil enforcement actions, such as anti-fraud and anti-manipulation actions, for securities laws violations after the fact, and (2) *regulatory* authority, including over digital asset securities, which could include registration requirements, oversight, and principles-based regulation.[218] Also, the Commodity Exchange Act provides the CFTC with enforcement and regulatory authority over digital asset derivatives.[219] However, the CFTC has enforcement authority, *not* regulatory authority, over the spot market of digital asset commodities.[220]

---

[211] For more details, see SEC, *Framework for "Investment Contract" Analysis of Digital Assets*, April 3, 2019, https://www.sec.gov/files/dlt-framework.pdf.

[212] SEC Chair Gary Gensler, "Kennedy and Crypto," September 8, 2022, https://www.sec.gov/news/speech/gensler-sec-speaks-090822.

[213] Coinbase, *Petition for Rulemaking—Digital Asset Securities Regulation*, July 21, 2022, https://assets.ctfassets.net/c5bd0wqjc7v0/5NRidtW8lvwVEfSHpndWQm/78f95afa4f0ebaaefb303e1a4f172d03/Coinbase_petition_for_SEC_rulemaking.pdf.

[214] For more on derivatives, see CRS In Focus IF10117, *Introduction to Financial Services: Derivatives*, by Rena S. Miller.

[215] For more on initial coin offerings, see PDF page 9 of CRS Report R46208, *Digital Assets and SEC Regulation*, by Eva Su.

[216] SEC Division of Corporate Finance Director William Hinman, "Digital Asset Transactions: When Howey Met Gary (Plastic)," speech delivered at Yahoo Finance All Markets Summit: Crypto, San Francisco, CA, June 14, 2018, https://www.sec.gov/news/speech/speech-hinman-061418.

[217] For example, a digital asset securities trading platform could be subject to securities regulation. Bitcoin is not a security, but the Bitcoin exchange-traded fund share is a security and would be subject to securities regulation. In addition, as former SEC Chair Jay Clayton stated, "regulated financial entities that allow for payment in cryptocurrencies, allow customers to purchase cryptocurrencies on margin or otherwise use cryptocurrencies to facilitate securities transactions should exercise caution, including ensuring that their cryptocurrency activities are not undermining their anti-money laundering and know-your-customer obligations." Testimony of SEC Chairman Jay Clayton in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, February 6, 2018, https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission.

[218] Julia Black, *The Rise, Fall and Fate of Principles Based Regulation*, November 21, 2010, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1712862.

[219] CFTC Commissioner Dawn Stump, "Digital Assets: Clarifying CFTC Regulatory Authority and the Fallacy of the Question, 'Is it a Commodity or a Security?,'" https://www.cftc.gov/media/6306/DigitalAssetsAuthorityInfographic_CommStump082321/download.

[220] A spot market is where commodities or securities are traded for immediate delivery. The spot market is in contrast

While the CFTC does not regulate digital asset securities, if a digital asset instrument is a security-based derivative, the SEC and CFTC may both have jurisdiction.[221]

Perceived Crypto-Asset Regulatory Gap

Because crypto-asset commodities spot market activities receive CFTC oversight that generally pertains to enforcement (and not regulatory) authority, activities in these non-security crypto-asset markets are not subject to the same safeguards that apply in securities markets. Examples of such safeguards include certain rules and regulations that encourage market transparency, conflict-of-interest mitigation, investor protection, and orderly market operations.

The Financial Stability Oversight Council (FSOC)—a systemic risk oversight body—has published recommendations related to this "regulatory gap," encouraging Congress to pass legislation that provides regulatory authority for federal financial regulators over spot markets for crypto-assets that are not securities.[222] FSOC states that this new rulemaking authority "should not interfere with or weaken market regulators' current jurisdictional remits."[223]

Some Members of Congress have also proposed legislation to address the perceived crypto-asset regulation gap through the redesign of SEC and CFTC jurisdiction.[224]

Financial regulators have traditionally followed the "same activity, same risk, same regulation" principle to mitigate the potential risks of regulatory arbitrage.[225] When designing a new regulatory landscape, policymakers face challenging questions such as how (or if) they should level the playing field between different types of crypto-assets (e.g., between digital asset securities and commodities) as well as between crypto-assets and traditional assets (e.g., between crypto-assets and stocks and bonds).

For Further Information

For questions on digital asset securities regulation, contact Eva Su, Analyst in Financial Economics.

For questions on financial technology, contact Paul Tierno, Analyst in Financial Economics.

For questions on securities and banking laws and how courts have interpreted such issues, contact Jay Sykes, Legislative Attorney.

Additional reading on digital asset securities is available in:

CRS Report R46208, *Digital Assets and SEC Regulation*, by Eva Su

CRS Testimony TE10066, *America on 'FIRE': Will the Crypto Frenzy Lead to Financial Independence and Early Retirement or Financial Ruin?*, by Eva Su

---

to the futures derivatives market, where delivery is at a later time.

[221] Stump, *Digital Assets*.

[222] FSOC, *Report on Digital Asset Financial Stability Risks and Regulation*.

[223] FSOC, *Report on Digital Asset Financial Stability Risks and Regulation*.

[224] For example, the Lummis-Gillibrand Responsible Financial Innovation Act (S. 4356) and the Digital Commodity Exchange Act of 2022 (H.R. 7614). See CRS Insight IN11971, *How the Lummis-Gillibrand Responsible Financial Innovation Act (S. 4356) Would Alter the Crypto Regulatory Landscape*, by Andrew P. Scott et al.

[225] Financial Stability Board, "FSB Proposes Framework for the International Regulation of Crypto-Asset Activities," October 11, 2022, https://www.fsb.org/2022/10/fsb-proposes-framework-for-the-international-regulation-of-crypto-asset-activities.

CRS Insight IN12052, *SEC Jurisdiction and Perceived Crypto-Asset Regulatory Gap: An FTX Case Study*, by Eva Su

CRS Report R47425, *Cryptocurrency: Selected Policy Issues*, by Paul Tierno

CRS Legal Sidebar LSB10832, *Crypto Assets and Property of the Bankruptcy Estate: An Analysis*, by Michael D. Contino

Policy Issue: Stablecoins

Stablecoins are digital assets generally designed to maintain a stable value by linking the value to a national currency or other reference assets.[226] The term *stablecoin* does not affirm that a particular coin actually achieves a stable value. Some consider terms such as *private asset-linked tokens* as better descriptors.[227] Many stablecoins have different operational structures and reserve compositions. Reserve assets backing stablecoins include fiat currencies, traditional financial assets, or other digital assets.

Many stablecoins at the current stage of development are primarily used for payment functions to facilitate digital asset trading and lending. Although stablecoins represent a relatively small fraction (5%) of the digital asset industry's total value, they facilitated more than 75% of trading on all digital asset trading platforms as of October 31, 2021.[228] Stablecoin-related policy concerns include issues related to market integrity, investor protection, financial stability, monetary policy, payments, and illicit activity prevention.

Stablecoins are arguably similar to other financial instruments. In addition, stablecoins' management and structuring of the reserve funds resemble existing practices at MMFs and ETFs.

Stablecoins resemble certain investment funds. Stablecoins often have reserve asset portfolios that hold assets backing the coins' values. Many industry observers and some regulators believe that the general mechanisms involved in creating, distributing, and redeeming stablecoins—and the means by which stablecoins aim to maintain their pegs with a reference asset—resemble similar mechanisms employed by MMFs and ETFs, which are regulated by the SEC.[229] Some commentators have thus argued that stablecoins should be regulated as investment companies by the SEC.[230]

Stablecoins also have money and payment characteristics. Some observers view stablecoins as a new form of private money that closely resembles the "wildcat" banknotes of the mid-19th century.[231] During the "wildcat" or "free banking" era (1837-1863), state-chartered banks issued

[226] President's Working Group on Financial Markets, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, *Report on Stablecoins*, November 1, 2021, https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

[227] Financial Stability Board, "Regulation, Supervision and Oversight of 'Global Stablecoin' Arrangements," October 13, 2020, https://www.fsb.org/wp-content/uploads/P131020-3.pdf#page=13.

[228] SEC Chair Gary Gensler, "Statement on President's Working Group Report on Stablecoins," November 1, 2021, https://www.sec.gov/news/statement/gensler-statement-presidents-working-group-report-stablecoins-110121.

[229] Board of the International Organization of Securities Commissions, *Global Stablecoin Initiatives*, March 2020, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD650.pdf.

[230] Helene Braun, "Asset Manager Van Eck Says Stablecoins Should Be Treated as Investment Funds, Not Banks," *CoinDesk*, February 15, 2021, https://www.coindesk.com/markets/2022/02/11/asset-manager-van-eck-says-stablecoins-should-be-treated-as-investment-funds-not-banks.

[231] Gary Gorton and Jeffery Zhang, "Taming Wildcat Stablecoins," September 30, 2021, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3888752.

their own currencies and sometimes refused to redeem their notes. This era ended with the National Bank Act of 1863,[232] which established the Office of the Comptroller of the Currency and charged it with chartering and regulating national banks, which in turn issued a uniform national currency.

When discussing stablecoins, some regulators reference the wildcat era, questioning the "long-term viability for five or six thousand private forms of money."[233] Some academic researchers argue that "money" must satisfy the "no-question-asked" principle, meaning an instrument is accepted in a transaction without due diligence regarding its value.[234] Stablecoins arguably do not satisfy this principle in their current form.

Some observers have voiced financial stability concerns regarding stablecoins. Some commentators have argued that stablecoins are vulnerable to runs if investors lose confidence in the assets backing them. Such runs might create contagion risks for other crypto-assets and even the traditional financial system. Some stablecoins have already experienced runs, though their impact was largely confined to the crypto ecosystem.[235]

Some observers have also argued that stablecoins are not adequately regulated.[236] In the traditional financial system, various regulations and protections—such as deposit insurance, capital and liquidity requirements, and liquidity facilities—help minimize run risk. Stablecoin investors do not have such protections.

Policy Proposals

Some Members of Congress and financial regulators have perceived gaps in the existing stablecoin regulatory frameworks and proposed policy alternatives.[237] Among other options, commentators have proposed regulating stablecoin issuers as (1) MMFs; (2) MMFs subject to increased prudential measures, such as additional capital requirements and liquidity buffers; (3) special purpose banks; (4) insured depository institutions; and (5) FSOC-designated systemically important entities. Alternatively, stablecoin issuers could be regulated under a separate new framework administered by a specialist digital asset regulator.

Policy debates during the second half of 2022 gave more recognition to the different types of stablecoins (e.g., money-like stablecoins and others). Some stablecoin proposals echoed aspects of international practices or proposals in the European Union and Japan in separating the money-

[232] 12 U.S.C. §38.

[233] SEC Chair Gary Gensler statement quoted by media. See Helaine Olen, "Think You're the One to Beat the Crypto Crash? Think Again," *Washington Post*, May 23, 2022, https://www.washingtonpost.com/opinions/2022/05/23/cryptocurrency-crash-vulnerable-investors.

[234] Gary Gorton, *The History and Economics of Safe Assets*, National Bureau of Economic Research Working Paper no. 22210, April 2016, https://www.nber.org/system/files/working_papers/w22210/w22210.pdf.

[235] For example, the Iron Titanium token faced a run-like scenario in June 2021, and TerraUSD faced a run-like scenario in May 2022.

[236] Paul Kiernan, "Yellen Renews Call for Stablecoin Regulation After TerraUSD Stumble," *Wall Street Journal*, May 10, 2022, https://www.wsj.com/articles/yellen-renews-call-for-stablecoin-regulation-after-terrausd-stumble-11652208165.

[237] For example, the Stablecoin Transparency Act (H.R. 7328 and S. 3970, 117th Congress); the Digital Asset Market Structure and Investor Protection Act (H.R. 4741, 117th Congress); the Lummis-Gillibrand Responsible Financial Innovation Act (S. 4356, 117th Congress); the Stablecoin TRUST Act of 2022 discussion draft; the Stablecoin Classification and Regulation Act of 2020 (H.R. 8827, 116th Congress); and the Managed Stablecoins are Securities Act of 2019 (H.R. 5197, 116th Congress). See also the President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, *Report on Stablecoins*.

like payment stablecoins from other forms of stablecoins and subjecting the money-type stablecoins to certain banking regulations.[238]

For Further Information

For questions on stablecoin regulatory design, contact Eva Su, Analyst in Financial Economics.

For questions on crypto-asset payments, money tramsmitters, and bank charters, contact Andrew Scott, Analyst in Financial Economics.

For questions on securities and banking laws and how courts have interpreted such issues, contact Jay Sykes, Legislative Attorney.

For questions on financial technology, contact Paul Tierno, Anslyst in Financial Economics.

Additional reading on stablecoins is available in:

CRS In Focus IF11968, *Stablecoins: Background and Policy Issues*, by Eva Su

CRS Insight IN11713, *How Stable Are Stablecoins?*, by Eva Su

CRS Insight IN11928, *Algorithmic Stablecoins and the TerraUSD Crash*, by Paul Tierno, Andrew P. Scott, and Eva Su

CRS Legal Sidebar LSB10753, *Stablecoins: Legal Issues and Regulatory Options (Part 1)*, by Jay B. Sykes

CRS Legal Sidebar LSB10754, *Stablecoins: Legal Issues and Regulatory Options (Part 2)*, by Jay B. Sykes

CRS Report R46486, *Telegraphs, Steamships, and Virtual Currency: An Analysis of Money Transmitter Regulation*, by Andrew P. Scott

Capital Market Volatility and Market-Driven Events

History shows that capital markets generally provide reliable sources of financing for businesses. Businesses can obtain such funding by, for example, issuing stocks and bonds. The funding can then be used for equipment purchases, research and development, employee salaries, or other functions that could facilitate operations and growth. Institutions and households can partake in these growth opportunities by investing in stocks, bonds, and funds with the hope of future returns.

In crisis conditions, however, capital market functions can come to a halt. Certain markets may no longer generate transactions, or the transactions may become abnormally expensive. Previously ubiquitous funding channels can become unreliable, creating funding shortages for businesses and financial losses for investors. Furthermore, businesses and investors might start to

[238] For European Union practices, see European Commission, "Proposal for a Regulation on Markets in Crypto-Assets," September 24, 2020, https://eurlex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020PC0593. For related legislation in Japan, see Japanese language text of the law at https://www.sangiin.go.jp/japanese/joho1/kousei/gian/208/pdf/s0802080472080.pdf. Analysis using English media sources by Natsumi Iwata and Keita Sekiguchi, "Japan Adopts Law to Regulate Stablecoins for Investor Protection," *Nikkei Asia*, June 3, 2022, https://asia.nikkei.com/Spotlight/Cryptocurrencies/Japan-adopts-law-toregulate-stablecoins-for-investor-protection; and Taiga Uranaka and Yuki Hagiwara, "Japan Passes Stablecoin Bill That Enshrines Investor Protection," *Bloomberg*, June 2, 2022, https://www.bloomberg.com/news/articles/2022-06-03/japan-passesstablecoin-bill-that-enshrines-investor-protection.

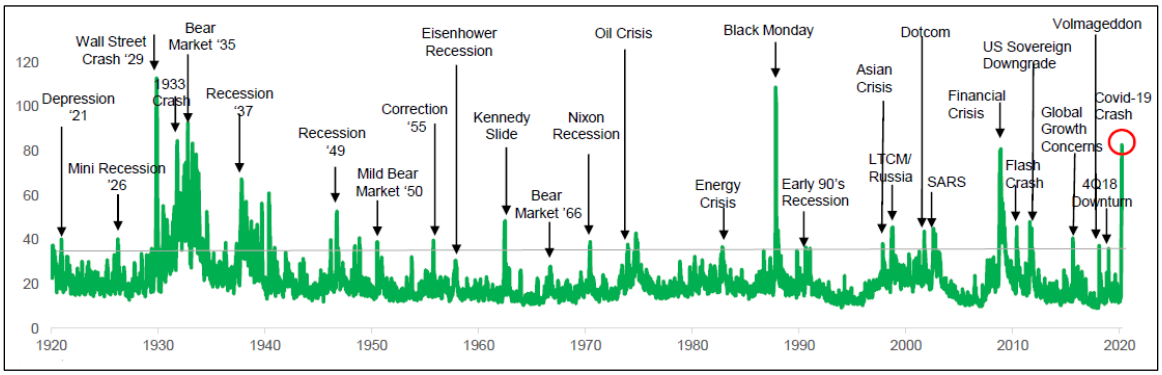
hoard cash and sell risky assets. These activities may lead to asset devaluation, fire sales, and bankruptcies that may have a negative ripple effect on the broader economy.

The uncertainties surrounding crisis conditions can increase volatility, meaning markets experience greater price fluctuation and dispersion.[239] Volatility is a common indicator of risk—excessive volatility often coincides with market turmoil or high levels of uncertainty.[240]

Policy Issue: Tools to Ease Extreme Market Conditions

Periods of abnormally high capital market volatility have occurred throughout financial history (**Figure 7**). The uncertainties that have triggered such events have varied widely—from pandemics to financial system breakdowns to geopolitical risks. Policy responses to such episodes have depended on the size of the potential harm and how widely risks have spread. In some situations, risks built up in expected patterns. In other situations, heightened stress revealed unexpected areas of vulnerability, and unprecedented policy solutions were needed to address them. For example, during the COVID-19-induced selloff, market dislocations were broadly felt, and the policy response included a mix of novel and preexisting tools.[241]

Figure 7. Modeled Market Volatility (VIX Index) over a Century



Source: BNP Paribas, *100 Years of Crashes: COVID-19 Crisis Playbook*, April 17, 2020.

Note: The VIX index is a market index that measures the market's expectation of 30-day forward-looking volatility using inputs from S&P 500 options.

Market volatility may warrant policy attention when it reveals areas of structural vulnerability. Congress and the SEC have responded to such issues in several ways.

Potential SEC Responses

The SEC has responsibilities regarding capital market operations, systemic risk, and financial stability.[242] For example, during the pandemic-induced market selloff in early 2020, its

[239] Volatility is a statistical measure of the degree of variation in a financial instrument's trading price observed over a period of time. It can be historical or implied, and volatility itself can also be a tradable market instrument. A market index, called the VIX index, is often used to measure the market's expectation of 30-day forward-looking volatility using inputs from S&P 500 options. This report does not cover the technical details of volatility.

[240] For more on market volatility, see CRS Report R46424, *Capital Markets Volatility and COVID-19: Background and Policy Responses*, by Eva Su.

[241] See CRS Report R46424, *Capital Markets Volatility and COVID-19: Background and Policy Responses*, by Eva Su.

[242] The SEC is a member of FSOC, which has a statutory mandate for identifying risks and responding to emerging threats to financial stability. FSOC, "About FSOC," https://home.treasury.gov/policy-issues/financial-markets-

responsibilities included (1) monitoring market price movements and the availability and flows of capital, and related actions, including regulatory relief; (2) ensuring the continuous, orderly, and fair functioning of the securities markets; and (3) facilitating timely and accurate disclosures of material information to ensure market transparency.[243]

The SEC's existing tools to help manage market volatility include circuit breakers and limit-up-limit-down (LULD) mechanisms. Circuit breakers are market-wide temporary halts that occur at three single-day S&P 500 index decline thresholds—7% (level 1), 13% (level 2), and 20% (level 3).[244] The level 1 and 2 circuit breakers generally enforce 15-minute pauses, and the level 3 circuit breaker halts the market for the rest of the day.[245] LULDs are single-stock halts enforced by "price bands" of 5%, 10%, 20%, or the lesser of $0.15 or 75%, depending on the stock price over the immediately preceding five-minute trading period.[246] The LULD mechanism forces a stock to take a five-minute trading pause if its price increases or decreases outside of these price bands.

Both market-wide and single-stock halts were designed to allow investors to pause and digest information during volatile and fast-paced market movements. While some believe the halts serve the purpose of calming market volatility, others argue that the halts can be disruptive, especially when circuit breakers are tripped immediately following market openings.[247]

In addition to these existing mechanisms, other proposals to address market volatility include banning short sales and revisiting the SEC's uptick rule that applies short-selling restrictions.[248] Proponents of such measures argue that short sales exacerbate market declines and so should be restricted. Others have rejected that argument, pointing to evidence that past impositions of short-sale restrictions have coincided with poor stock market performance.[249]

Some observers have also argued that shutting down stock markets or opening them for a shorter trading day may calm extreme market volatility. Views on this approach are mixed, with some observers believing total shutdowns are problematic.[250]

---

financial-institutions-and-fiscal-service/fsoc/about-fsoc.

[243] Former SEC Chairman Jay Clayton, "Remarks to the Financial Stability Oversight Council," May 14, 2020, https://www.sec.gov/news/speech/clayton-remarks-financial-stability-oversight-council-051420. For specific examples, see SEC, "SEC Coronavirus (COVID-19) Response," https://www.sec.gov/sec-coronavirus-covid-19-response.

[244] SEC, "Investor Bulletin: Measures to Address Market Volatility," July 1, 2012, https://www.sec.gov/oiea/investor-alerts-bulletins/investor-alerts-circuitbreakersbulletinhtm.html.

[245] A market decline that triggers a level 1 or level 2 circuit breaker before 3:25 p.m. will halt market-wide trading for 15 minutes, whereas a similar market decline at or after 3:25 p.m. will not halt market-wide trading.

[246] SEC, "Investor Bulletin: Measures to Address Market Volatility."

[247] Alexander Osipovich and Dawn Lim, "Wall Street Explores Changes to Circuit Breakers After Coronavirus Crash," *Wall Street Journal*, April 15, 2020, https://www.wsj.com/articles/wall-street-explores-changes-to-circuit-breakers-after-coronavirus-crash-11586952558.

[248] For more on the uptick rule, see SEC, "SEC Approves Short Selling Restrictions," press release, February 24, 2015, https://www.sec.gov/news/press/2010/2010-26.htm.

[249] Robert Battalio, Hamid Mehran, and Paul Schultz, "Market Declines: What Is Accomplished by Banning Short-Selling?," Federal Reserve Bank of New York, 2012, https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci18-5.pdf.

[250] Reuters, "U.S. Finance Industry Says Markets Must Stay Open During Pandemic," March 20, 2020, https://www.reuters.com/article/us-health-coronavirus-usa-markets/u-s-finance-industry-says-markets-must-stay-open-during-epidemic-idUSKBN21720O.

Potential Legislative Responses

To address extreme market volatility, Congress could pass laws to provide fiscal stimulus and liquidity support during financial crises. For example, provisions in Division A, Title IV, of the CARES Act (P.L. 116-136), enacted during the COVID-19 pandemic, affected capital market conditions.[251] Some of the provisions allowed the Department of the Treasury to provide loans, loan guarantees, and other backstops for businesses and Federal Reserve facilities and provide financial assistance to certain segments of the economy.[252] However, such measures sometimes entail a potential tradeoff. When the government backstops markets, it may contribute to "moral hazard"—a phenomenon whereby market participants take on excessive risk in the belief that another party, in this case the government, will bear some of the potential costs.[253]

For Further Information

For questions about capital markets volatility, contact Eva Su, Analyst in Financial Economics.

Additional reading on market volatility is available in:

CRS Report R46424, *Capital Markets Volatility and COVID-19: Background and Policy Responses*, by Eva Su

CRS Insight IN11494, *Why Have Stock Market and Real Economy Diverged During the COVID-19 Pandemic?*, by Eva Su

CRS Insight IN11309, *COVID-19 and Stock Market Stress*, by Eva Su

CRS Insight IN11275, *COVID-19 and Corporate Debt Market Stress*, by Eva Su

CRS Insight IN11591, *GameStop-Related Market Volatility: Policy Issues*, by Eva Su

CRS In Focus IF11825, *Family Office Regulation in Light of the Archegos Fallout*, by Gary Shorter and Eva Su

CRS In Focus IF11673, *"Zombie" Companies: Background and Policy Issues*, by Eva Su

SEC Agency Operations

Congress passed the Securities Exchange Act of 1934 (P.L. 73-291) to create the SEC in the wake of the stock market crash in 1929 to help restore confidence in capital markets. The SEC is an independent federal regulatory agency responsible for administering federal securities laws. It is led by five presidentially appointed commissioners, including a chair, subject to Senate confirmation. Commissioners have staggered five-year terms, and no more than three commissioners may belong to the same political party.

The SEC oversees federal securities laws broadly aimed at (1) protecting investors; (2) maintaining fair, orderly, and efficient markets; and (3) facilitating capital formation.[254] These laws provide rules for honest dealing among securities market participants, including antifraud

[251] For more on the CARES Act (P.L. 116-136), see CRS Report R46301, *Title IV Provisions of the CARES Act (P.L. 116-136)*, coordinated by Andrew P. Scott.

[252] See CRS Report R46301, *Title IV Provisions of the CARES Act (P.L. 116-136)*, coordinated by Andrew P. Scott.

[253] One example of moral hazard involves financial institutions that are considered "too-big-to-fail" (TBTF). Because institutions that are TBTF expect that they will be bailed out if they experience financial difficulty, they may take excessive risks. For more on TBTF, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

[254] SEC, "Our Goals," https://www.sec.gov/our-goals.

provisions, and require public companies to disclose information deemed necessary for informed investor decisionmaking.

The SEC's budget is set through the congressional appropriations process. Sale fees on stock and other securities transactions that the SEC collects from securities exchanges offset the appropriations. Annual collections, which historically exceeded the SEC's annual appropriations, go directly to the U.S. Treasury's General Fund. Over the past few years, the SEC's enacted annual budget has been close to $2 billion.

The SEC has close to 5,000 full-time equivalent employees across six divisions, one independent office (inspector general), and 11 regional field offices. **Figure 8** illustrates the SEC's main divisions.

- The **Corporation Finance Division** is responsible for the review of securities issuer filings and disclosure.[255]
- The **Enforcement Division** takes actions to deter misconduct and punish securities law violations.[256]
- The **Examinations Division** conducts the SEC's National Exam Program that involves onsite examinations of market participants such as investment management companies and advisers, broker-dealers, clearing agencies, and self-regulatory organizations (e.g., FINRA, MSRB, and national securities exchanges).[257]
- The **Investment Management Division** regulates investment management companies and investment advisers pursuant to the Investment Company Act of 1940 and Investment Advisers Act of 1940 (P.L. 76-768).[258]
- The **Trading and Markets Division** oversees capital market infrastructure and its participants to help maintain fair, orderly, and efficient markets.[259]
- The **Economic and Risk Analysis Division** provides cross-divisional support for the agency on research, economic analysis, and data analytics.[260]

[255] SEC, "Division of Corporation Finance," https://www.sec.gov/page/corpfin-section-landing.

[256] SEC, "Division of Enforcement," https://www.sec.gov/page/enforcement-section-landing.

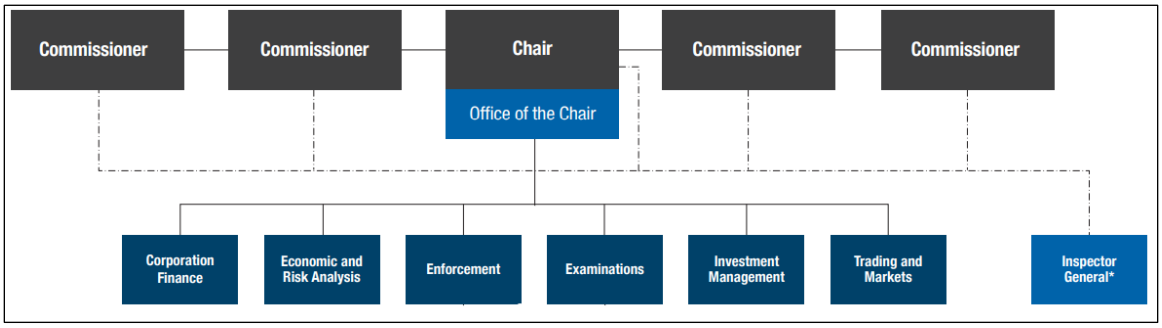
[257] SEC, "Division of Examination," https://www.sec.gov/exams.

[258] SEC, "Division of Investment Management," https://www.sec.gov/investment-management.

[259] SEC, "Trading and Markets," https://www.sec.gov/divisions/trading-markets.

[260] SEC, "Economic and Risk Analysis," https://www.sec.gov/dera.

Figure 8. SEC Organizational Chart



Source: SEC, https://www.sec.gov/about/secorg.pdf.

Note: *Indicates an independent office.

Policy Issue: SEC Rulemaking Agenda Under Chair Gensler

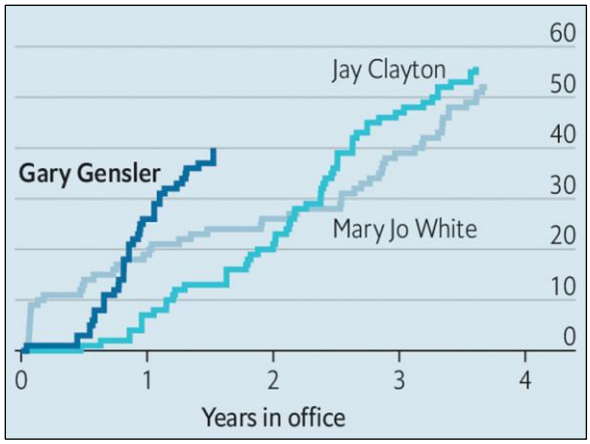
During SEC Chair Gary Gensler's tenure, which started in 2021, the SEC's rulemaking agenda has generated policy debate. The SEC's spring 2022 agency rule list consists of 53 items for the short-term agenda and eight items for the long-term agenda.[261] The agency had proposed 35 new rules in 2022, substantially more than in previous years.[262] In addition, relative to other recent SEC chairs during the Trump and the Obama Administrations, Gensler's pace of rulemaking appears substantially higher (**Figure 9**).[263] Policy debates include (1) whether the recent pace of rulemaking allowed enough time for participants to consider and comment on new rules, (2) whether some of the SEC's proposed rules exceed the agency's legal authority, and (3) whether important issues perceived to warrant new rulemaking have been addressed in a timely manner. This section discusses each of these topics in more detail.

[261] For the short-term agenda, see SEC, "Agency Rule List—Spring 2022," https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=C3F61296B896EEB30E0DB0BF6800703CB28489E9081F8F5D325D6B4BD47976AA2C146534BEF01AA9E7A5029B8C150A52F066https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=C3F61296B896EEB30E0DB0BF6800703CB28489E9081F8F5D325D6B4BD47976AA2C146534BEF01AA9E7A5029B8C150A52F066. For long-term agenda, see SEC, "Agency Rule List—Spring 2022," https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPubId=202204&showStage=longterm&agencyCd=3235&csrf_token=7B0ECEF5C9C8C5E68CD0C9B5E478073A4E471590DB23590B848779794A7811ABD0FAEE22374B05824061237E3E5FE01DEEC2.

[262] SEC, "SEC Proposed Rules," https://www.sec.gov/rules/proposed.shtml.

[263] SEC, "SEC Historical Summary of Chairmen and Commissioners," https://www.sec.gov/about/sechistoricalsummary.

Figure 9. Rules Proposed or Finalized by SEC Chairs



Source: *The Economist*, "Can Gary Gensler Solve Every Problem in American Finance?," October 26, 2022, https://www.economist.com/finance-and-economics/2022/10/26/can-gary-gensler-solve-every-problem-in-american-finance.

Notes: For more details, see SEC, "SEC Historical Summary of Chairmen and Commissioners," https://www.sec.gov/about/sechistoricalsummary; SEC, "SEC Proposed Rules," https://www.sec.gov/rules/proposed.shtml; and SEC, "SEC Final Rules," https://www.sec.gov/rules/final.htm.

Some observers requested the SEC to extend the comment period for its rulemaking process.[264] They argued that the relatively short comment period may not leave sufficient time for industry stakeholders to research, analyze, and provide quality comments on substantive changes. Other observers argue that the short and overlapping comment periods may place cumulative challenges on the industry's capacity to respond.[265] The discussions have gained more momentum since April 2022, when a group of 47 House Members (117th Congress, 28 Democrats and 19 Republicans) and 25 industry groups sent letters to the SEC to express concern over the length of certain comment periods that "may hamper the ability for the public to provide effective and meaningful input."[266]

In addition, some observers question the SEC's authority for certain rulemakings, while others note the absence of certain important topics from the agenda. Regarding the former issue, attorneys general from 24 states sent a letter to the SEC regarding "the major questions doctrine," in which they claim that, in some cases, the agency "must point to clear congressional authorization for the power it claims."[267] Regarding the latter, while the scope of the current SEC

[264] Rep. Patrick McHenry and Sen. Pat Toomey, letter to the SEC, January 10, 2022, https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf.

[265] Al Barbarino, "SEC Under Fire Over Shorter Rule Proposal Comment Periods," *Law360*, March 9, 2022, https://www.law360.com/banking/articles/1471291/sec-under-fire-over-shorter-rule-proposal-comment-periods; and SIFMA, "Substantive and Procedural Concerns with the SEC's Regulatory Agenda," September 20, 2022, https://www.sifma.org/resources/news/substantive-and-procedural-concerns-with-the-secs-regulatory-agenda.

[266] Member letter to the SEC, "Private Fund Advisers; Documentation of Registered Investment Compliance Reviews ('Private Fund NPRM')," April 13, 2022, https://subscriber.politicopro.com/f/?id=00000180-29a6-d749-ab92-b9bf20d30000. Industry group letter to the SEC, "Importance of Appropriate Length of Comment Periods," April 5, 2022, https://www.sifma.org/wp-content/uploads/2022/02/SEC_Joint-Trades_Comment-Period-Letter_4-5-2022.pdf.

[267] State attorneys general letter to the SEC, Supplemental Comments on Proposed Rule Amendments titled "The Enhancement and Standardization of Climate-Related Disclosures for Investors" by the Attorneys General of the States of West Virginia, Arizona, Alabama, Alaska, Arkansas, Florida, Georgia, Idaho, Indiana, Kansas, Kentucky, Louisiana, Mississippi, Missouri, Montana, Nebraska, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Utah, Virginia, and Wyoming (SEC File No. S7-10-22), July 13, 2022, https://ago.wv.gov/Documents/Q0664665.pdf.

rulemaking agenda is extensive, advocates for increased regulatory clarity in certain areas believe that the SEC did not address some of the most obvious policy issues. For example, one of the SEC commissioners argued that certain large and complex issues, such as digital asset regulation, are absent from the agenda.[268]

The SEC's Office of Inspector General raised concerns about how the rulemaking activities have led to increased risks and resource shortages, stating in October 2022 that "some believed that the more aggressive agenda—particularly as it relates to high-profile rules that significantly impact external stakeholders—potentially (1) limits the time available for staff research and analysis, and (2) increases litigation risk."[269]

The SEC introduced its agenda items while citing a 1963 statement—"no regulation can be static in a dynamic society."[270] Gensler stated that by updating its rules, the SEC will modernize them for changing market environments and potentially create more market efficiency.[271] Gensler further argued that it is important to "move to the next steps in the rulemaking process to determine whether the SEC should re-propose, modify, or adopt the proposed rules based upon the feedback."[272] On another occasion, Gensler responded to concerns regarding agency rulemaking processes, citing the number of rules finalized during multiple former SEC Chairs' full tenures, believing his pace of rulemaking is "right in the zone."[273]

For Further Information

For questions about SEC regulation and capital markets rulemaking, contact Eva Su, Analyst in Financial Economics.

For questions about SEC agency operations, contact Gary Shorter, Specialist in Financial Economics.

Additional reading on the SEC is available in:

CRS In Focus IF11714, *Introduction to Financial Services: The Securities and Exchange Commission (SEC)*, by Gary Shorter.

CRS In Focus IF11062, *Introduction to Financial Services: Capital Markets*, by Eva Su.

[268] SEC Commissioner Mark Uyeda, "Remarks at the 'SEC Speaks' Conference 2022," September 9, 2022, https://www.sec.gov/news/speech/uyeda-speech-sec-speaks-090922.

[269] SEC Office of Inspector General, "The Inspector General's Statement on the SEC's Management and Performance Challenges," October 13, 2022, https://www.sec.gov/files/inspector-generals-statement-sec-mgmt-and-perf-challenges-october-2022.pdf.

[270] SEC, "SEC Announces Spring 2022 Regulatory Agenda," press release, June 22, 2022, https://www.sec.gov/news/press-release/2022-112.

[271] SEC, "SEC Announces Spring 2022 Regulatory Agenda."

[272] Quoted text is a summary by Soyoung Ho, "Gensler Defends 30, 45-Day Comment Period for SEC Rulemaking Proposals," Reuters, January 24, 2022, https://tax.thomsonreuters.com/news/gensler-defends-30-45-day-comment-period-for-sec-rulemaking-proposals.

[273] Soyoung Ho, "SEC Chair Gensler Defends Fast-Paced Rulemaking," Thomson Reuters, October 5, 2022, https://tax.thomsonreuters.com/news/sec-chair-gensler-defends-fast-paced-rulemaking.

Author Information

Eva Su, Coordinator
Analyst in Financial Economics

Rena S. Miller
Specialist in Financial Economics

Gary Shorter
Specialist in Financial Economics

John J. Topoleski
Specialist in Income Security

Jay B. Sykes
Legislative Attorney

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.