Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

CHOICE Act's Potential Outsized Influence On The SEC

By **Daniel Chirlin, Walden Macht & Haran LLP**

Law360, New York (May 16, 2017, 5:40 PM EDT) --

Daniel Chirlin

Much ink has been spilled — both in briefs and in the court of public opinion — debating the U.S. Securities and Exchange Commission's unfettered use of administrative proceedings to bring enforcement actions against respondents. But recently, the House Financial Services Committee brought the country one small step closer to circumscribing the SEC's enforcement authority and effectively eliminating administrative proceedings as an enforcement tool.

On May 4, 2017, the Financial Services Committee voted to approve the Financial Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs Act (CHOICE Act) — an initial step toward rolling back some of the major reforms imposed by the Obama administration in its signature post-financial crisis Dodd-Frank Wall Street Reform and Consumer Protection Act. The previous iteration of the CHOICE Act was adopted in the Financial Services Committee in June 2016, but did not advance for a full House vote.

While there is no way to know for certain what, if anything, will survive the passage of the bill through the House and Senate, the reform and partial repeal of the Dodd-Frank Act is clearly a priority for the Trump administration.[1] Among other things, the CHOICE Act seeks to take on portions of Dodd-Frank that have been heavily criticized, such as the exceedingly difficult-to-implement Volcker Rule (prohibiting banks from engaging in proprietary trading),[2] the widely lamented — by Wall Street — U.S. Department of Labor fiduciary rule (ascribing a fiduciary duty to all financial advisers who work with retirement plans or provide retirement advice),[3] the "too big to fail" liquidity process,[4] and the controversial Durbin Amendment (cap on debit card interchange fees that many argue has been detrimental to consumers).[5] However, in addition to these big-ticket items, the proposed law also contains several more under-the-radar provisions that, collectively, could have a significant impact on SEC enforcement.

Under the guise of shifting focus from companies to individual offenders, the CHOICE Act would impose an obligation on the SEC to undertake an economic analysis before enforcing civil penalties to demonstrate that the company benefited from the alleged wrongdoing and that the penalty does not harm the shareholders — likely at the expense of the post-financial-crisis hundred-million-dollar settlements with the big banks. [6] At the same time, the act proposes to double or triple certain statutory penalties for violations of the securities laws. In theory, this approach will protect shareholders while still serving as a deterrent to individual bad actors.

In practice, however, other provisions in the act provide even greater protection to SEC respondents than ever before.[7] Most notably, the new law would permit a respondent to remove any administrative proceeding to a federal district court.

Currently, the administrative proceeding process is one of the most effective weapons in the SEC's enforcement arsenal. The relaxed procedural rules (hearsay is permissible), the limited discovery, the shortened trial schedule and the SEC-paid judges all combine to create an overwhelming home-court advantage. Indeed, the SEC has fully embraced this advantage, bringing 91 percent of its enforcement proceedings against public company-related defendants before an administrative judge in the first half of the 2017 fiscal year, according to a Cornerstone Research report.[8] Removing this advantage could not only benefit defendants who would otherwise face the inhospitable environs of the administrative proceeding, but it could have a potentially significant impact on what cases the SEC might bring in the future, knowing that it could be subject to the more exacting rigor and procedural protections found in federal court — not to mention the added expense of drawn-out litigation. And further, even for cases that would remain before an administrative judge, the proposed law would raise the SEC's standard of proof from "preponderance of the evidence" to the more demanding "clear and convincing" evidence of wrongdoing.

It will also come as welcome news to SEC respondents (and defense practitioners) that the proposed law would limit the duration of SEC and U.S. Commodity Futures Trading Commission subpoenas and prescribe a process for the timely conclusion of SEC investigations. Under the law, respondents would also be guaranteed access to commissioners at the Wells process stage (before a formal complaint). In addition, the act would circumscribe the commission's ability to leverage settlement by threatening the company or individual with automatic disqualification from regulated activities. Instead, disqualification would now require a formal hearing. The SEC would also have to publish its enforcement manual, providing further transparency into filing decisions.[9]

In summary, the CHOICE Act offers a panoply of benefits to current and futures targets of SEC investigations. While the likelihood of passage is unknown, many of these provisions are likely to go unremarked upon in the rhetoric surrounding the more controversial aspects of the proposed law. But in terms of impact, they would likely have an outsized influence on the direction and future of SEC enforcement.

Daniel J. Chirlin is a senior counsel at Walden Macht & Haran LLP.

[1] Swanson, B. "Trump administration reinforces Dodd-Frank reform remains priority." Housingwire.com. Mar. 9, 2017. .

[2] See Title IX of Choice Act.

[3] See Title VIII of Choice Act.

[4] See Title I of Choice Act.

[5] See Title VII of Choice Act.

[6] Frankel, Alison. “House Financial Choice Act is boon for SEC targets.” Reuters.com. May 9, 2017.

[7] Id.

[8] “SEC Enforcement Actions against Public Companies and Subsidiaries Keep Pace with Last Two Years Issuer Reporting and Disclosure remains most frequent allegation type.” Cornerstone Research. May 9, 2017.

[9] In addition to curbing regulatory enforcement measures, the law would also curtail agency rulemaking authority and deference. The new provisions would require a comprehensive economic analysis of all proposed and final regulations to ensure that the benefits of the rule outweigh the costs. The law would also strip the agencies of their traditional Chevron doctrine deference.
