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House Financial Services Committee Questions SEC's Gensler On Crypto, Climate Risk Rule, Brisk Pace of Rulemaking

Republicans Fault SEC's 'Regulation by Enforcement' of Digital Assets, Citing 'Lack of Clarity'

The House Financial Services Committee today (Tuesday, April 18) held a hearing on "Oversight of the Securities and Exchange Commission." The only witness was SEC Chairman Gary Gensler. Materials from the hearing are posted here. The hearing provided committee Republicans with a long-awaited opportunity to confront Gensler about the SEC's aggressive series of proposed rules since 2021, including rules on climate risk, equity market structure, private fund advisers, open-end mutual funds and other areas. They also faulted Gensler's assertion of authority over most cryptocurrency products and the SEC's enforcement actions against crypto firms, while questioning his responsiveness to their oversight inquiries.

Statements

In a sharply worded opening statement, Chairman Patrick McHenry (R-NC) said that under Gensler's leadership, "the SEC has brought nearly 50 separate enforcement actions against digital asset firms. And now your agency is requesting an additional $78 million to expand your enforcement agenda. At the same time, you have refused to provide clarity on whether digital assets offered as part of an investment contract are subject to securities laws – and, more importantly, how these firms should comply with those laws," McHenry said. "You're punishing digital asset firms for allegedly not adhering to the law, when they don't know it will apply to them. That's nonsensical. Regulation by enforcement is not sufficient nor sustainable. Your approach is driving innovation overseas and endangering American competitiveness. The Ranking Member and I have worked for more than a year on this issue, and I will continue that work this Congress. Let me be clear: Our goal is to make law. We expect you to play a constructive role in that process."

McHenry said that in the past two years, the SEC "has proposed 53 new rules at a breakneck pace. That's twice as many rules as your predecessors, Mary Jo White and Jay Clayton, in the same amount of time. This raises serious concerns that the rulemaking process is being rushed, undermining the quality of our securities laws and risking negative unintended consequences. These concerns have been echoed by senior personnel at your own agency. And they are similar concerns raised while you were at the CFTC. Time and time again, you have cut the public out of the rulemaking process with unreasonably short comment periods, even for major rules like your disastrous climate disclosure proposal and equity market structure overhaul."

McHenry closed by criticizing Gensler's communication with Congress, saying, "Your responses to congressional inquiries have been unacceptable. We have a constitutional duty to conduct oversight of the agencies under our jurisdiction and we will continue to do so aggressively. If you continue to thwart this institution by ignoring or providing incomplete responses, we will be left with no choice but to pursue all avenues to compel the information or documents we need."

In her statement, Ranking Member Maxine Waters (D-CA) said, "We are here this morning because last Congress, Republicans threatened to do a 'big number' on the SEC and Chair Gensler, and today is the start of them making good on that promise. This playbook isn't new – committee Democrats and the American public have seen it all before. Under the first Consumer Financial Protection Bureau Director, Richard Cordray, Republicans worked around the clock to harass the agency with sham investigations, baseless subpoenas and nonstop hearings, all in hopes of delaying or impeding the important work of the agency. This is the same exact strategy they plan to use on the SEC, and unfortunately, everyday people will pay the price. The SEC has on average provided over twice the legally required time for comment on its proposals to strengthen Wall Street's rules, and yet Republicans still claim that things are still moving too fast, and are joining industry's efforts to attempt to delay these long-overdue reforms."

Meanwhile, Waters said, "Republicans are eager to rush forward with measures that would deregulate our capital markets. We just witnessed what Trump's deregulation means in the banking sector and financial stability, as the collapse of SVB and Signature Bank threatened confidence across the banking system." Waters applauded Gensler and his staff "for the forceful actions the SEC has taken and dedicated more resources to go after crypto criminals. This is a stark difference from the hands-off approach that the Republican SEC chair took to mass non-compliance in crypto."

Much of the prepared statement by SEC Chairman Gary Gensler focused on cryptocurrency issues. "Congress gave the Commission a mandate to protect investors, regardless of the labels or technology used," he said. "Nothing about the crypto markets is incompatible with the securities laws. As I've said numerous times, the vast majority of crypto tokens are securities…. These thousands of tokens often are supported by websites and social media accounts, and generally there are entrepreneurs backing them. The public generally is counting on the efforts of other humans behind these tokens to generate profits on their investment. Given that most crypto tokens are securities, it follows that many crypto intermediaries are transacting in securities and have to register with the SEC."

Gensler said both centralized and decentralized crypto intermediaries provide a variety of services – such as exchange functions, broker-dealer functions, custodial, clearing and lending services -- that are typically separated from each other in the rest of the securities markets. "The commingling of the various functions within crypto intermediaries creates inherent conflicts of interest and risks for investors –- risks and conflicts the Commission does not allow in any other marketplace," he said. "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called…. It's the law; it's not a choice," Gensler said. In a bit of wordplay, he added, "Calling yourself a 'DeFi' platform, for instance, is not an excuse to defy the securities laws."

Gensler said crypto investors, like equities investors, should benefit from protections against fraud, manipulation, front-running, wash sales and other misconduct. "Right now, unfortunately, this market is rife with noncompliance," he said. "This noncompliance not only puts investors at risk, but also puts at risk the public's trust in our capital markets."

QUESTIONS

SEC Enforcement Actions. Several Republicans on the committee criticized Gensler for "regulation by enforcement," with Chairman McHenry telling Gensler that it was irresponsible for the SEC to sue cryptocurrency firms for failing to register with the SEC when the law is not clear on whether some digital assets are securities or commodities. McHenry also noted that the CFTC has disputed with the SEC over which agency has the legal authority to regulate certain digital assets. Tom Emmer (R-MN) asked, "Does it concern you that your approach to the digital asset industry is actually driving this industry out of the United States?" Gensler replied, "I'm trying to drive it to compliance, and if they're not complying with the laws then they shouldn't be offering their products to U.S. investors."

Gensler contended that the SEC does not need additional authority from Congress to regulate the crypto sector, saying crypto firms' noncompliance "not only puts investors at risk, but also puts at risk the public's trust in our capital markets." Emmer countered, "You say the crypto industry is rife with noncompliance, yet existing SEC rules make no sense for blockchain-based companies, and following them would actually kill these businesses. Your regulatory style lacks flexibility and nuance, and as a result, you've been an incompetent cop on the beat, doing nothing to protect everyday Americans." When other members criticized him for failing to prevent the collapse of the FTX crypto exchange, Gensler said he had aired concerns about the dangers posed by unregistered crypto intermediaries well before the FTX crisis. "I've been very clear with many members of this industry that right now they need to come into compliance," he said.

Ranking Member Waters queried Gensler about whether the SEC had adequate authority and resources to crack down on cryptocurrency firms. Gensler told her, “We have the laws and the authority to oversee the crypto markets… I’ve never seen a field that is so noncompliant with laws written by Congress.” He added, “We could use more resources. There are more things to look at and investigate than we have people on the staff to do.”

In a letter to Gensler released shortly before the hearing, committee Republicans lambasted the SEC’s moves on digital assets, taking issue with the chairman’s repeated calls for crypto trading platforms to come in and register with the agency. “You have failed to provide a path that allows digital asset trading platforms to register,” they wrote. “Without clear rules of the road, your push for firms to ‘come in and register’ is a willful misrepresentation of the SEC’s non-existent registration process. The only entity to blame for the lack of registrants is the SEC itself.”

Crypto Assets: Securities vs. Commodities. In his questions, Chairman McHenry tried to pin Gensler down on the question of whether Ether, the second-largest cryptocurrency by market capitalization, was a security, but Gensler declined to go into specifics on any particular digital token. “Clearly an asset cannot be both a commodity and a security,” McHenry said. “I’m asking you, sitting in your chair now, to make an assessment under the laws as exist. Is Ether a commodity or a security? You have prejudged on this: you’ve taken 50 enforcement actions. We’re finding out as we go, as you file suit, as people get Wells notices, on what is a security in your view, in your agency’s view.” But Gensler would not make a specific assessment on Ether, instead repeating that securities laws are clear and that the SEC enforces laws that require disclosures to investors about investment vehicles. “It depends on the facts and the law. Mr. Chair, I think you would not want me to prejudge.” Gensler cited a long-standing precedent for SEC officials not to comment on the circumstances of specific cases, saying a token is a security when investors expect a profit from it.

“There’s a lack of clarity here in the marketplace. Can you at least agree to that?” McHenry said, but Gensler replied that it was clear the SEC has authority to regulate crypto. “It’s not a matter of lack of clarity,” he said. “We have a whole field in crypto that understands the law and that they are providing exchange services, broker-dealer services, clearing services of crypto security tokens… I think this is a field that, in the main, is built up around noncompliance and that’s their business model, and [firms] have chosen… to be noncompliant and to not provide investors with confidence protections, and it undermines the $100 trillion capital markets.” Later in the hearing, Gensler said, “I’ve been around finance for 40 years, in one way or the other. I’ve never seen a field that is so noncompliant with laws written by Congress and confirmed over and over again by the courts.”

Stephen Lynch (D-MA) said, “There is a fair amount of guidance out there and clarity; it’s just not the clarity that the crypto industry wants.” Brad Sherman (D-CA) said Congress should pass legislation to categorize all crypto assets as securities: “That way it would be very clear that investors in crypto get the same protection as investors in stock, bonds and other intangible assets acquired for an investment purpose,” he said.

Fast Pace of Rulemaking. As Chairman McHenry was in his opening statement, several other Republicans were critical of the aggressive pace of the SEC’s rulemaking under Gensler, often citing an October report by the SEC’s inspector general that raised concerns about the agency’s ability to carry out all of the rules it had proposed, and pointed to attrition among SEC staffers. “I get the impression from personnel across the SEC that there are concerns about the high volume and the fast pace of this rulemaking. Let’s try to get it right, not get it done in a hurry,” said Frank Lucas (R-OK). Gensler said the SEC’s comment periods average about 70 days, and the agency accepts written comments and takes meetings with stakeholders beyond comment deadlines. He said it typically takes at least a year before rules go from their initial proposal stage to being published in final form.

Ann Wagner (R-MO) said the large number of pending rules is likely preventing the SEC from considering the aggregate effect they may have on retail investors. “Your agenda is neither driven by congressional mandate… nor a widespread market failure like we saw in ‘08,” she said. Josh Gottheimer (D-NJ) asked about the potential impact on small businesses, saying the SEC’s many proposals often leads to “overlapping and rushed comment periods.” Gensler told him, "I'm very proud of what we've done. We put out 46 proposals to date… and on average, it's been more than 70 days from the time we vote it out, we put it on our website, and we have a formal end to a comment period. But then we get comments after that, and we take meetings after that, and we engage actively with trade associations and market participants."

Climate Risk Disclosure. A number of Republicans called on Gensler to drop a provision in the SEC's proposed climate risk disclosure rule that would place new "Scope 3" reporting requirements on private businesses that are part of a public company's supply chain. Gensler said the Commission is considering those comments when completing its final rule, and that the rule is not intended to put obligations on nonpublic companies. "We've gotten 15,000 comments. On the investors' side, it's almost uniformly supportive of mandating climate risk disclosures," he said. "Many of the comments we received from actual investors have said they would like to have better consistency around greenhouse gas emissions." Gensler added that hundreds of companies are already making climate disclosures because investors want them, and the SEC's goal is to make that information more consistent and comparable. "Our proposal and our authorities are about public companies, and that's what [the proposal] speaks to," he said. "We do not place through this proposal and nor do we intend to have any obligations on non-public companies."

Several members questioned whether the SEC has the authority to act on climate issue regulation, but Gensler said the agency is focused on information that can inform investors. Alex Mooney (R-WV) said, "The SEC has no business enacting climate policy. No matter what changes are made to the rule, it's rotten to the core and should be rescinded entirely. The SEC and the Biden administration must end its war on fossil fuels and return to focusing on the needs of investors, not activists." Roger Williams (R-TX) said, "The SEC's climate risk disclosure rule would have major consequences for the businesses across the country, especially smaller entities who lose out on opportunities because they cannot afford the increased compliance costs. This would be detrimental for companies and will stifle innovation and businesses' ability to grow." Other members said the rule could threaten jobs in states with substantial oil or coal production. "Our authority is just about the public registrants," Gensler said. "We are not a climate regulator, and we are neutral about that."

Democrats rallied to the agency's defense, with Ayanna Pressley (D-MA) saying, "Although the cheerleaders for Big Oil want to weaken this rule, the consequences are clear. Without a comprehensive climate disclosure regimen, we will fail working class people throughout our country. This is not the time to backtrack and to weaken regulations. Now is the time for action, and to put people over polluters."

SEC Transparency. In his questions, Bill Huizenga (R-MI) criticized the SEC for being unresponsive, saying that when he asked for documents relating to the climate risk proposal, the agency provided only publicly available information. Huizenga said Gensler sent "a copy of the public comment file on the rule… a copy of the rule itself – twice… a copy of your testimony the last time you appeared before this committee… a copy of your public calendar… copies of public speeches, testimony and press releases from you and your fellow commissioners… a copy of a public FSOC report from 2021." Huizenga continued, "The most interesting and frankly, the dumbest example of this that we received to date was a letter that myself and Chairman McHenry sent you congratulating you as being confirmed as chair in 2021. So frankly, it's insufficient and unacceptable what has been going on. I think it's an embarrassment to you and to your team that you sent me a copy of the letter I sent you." When Huizenga criticized Gensler for not responding to letters seeking information about the arrest of former FTX CEO Sam Bankman-Fried, Gensler said he is obliged to keep investigative matters confidential.

Swing Pricing, 4 p.m. EST Close. Steven Horsford (D-NV) mentioned the SEC's proposal for swing pricing in open-end mutual funds, which would require such funds to stop taking orders at 4 p.m. EST. "Upon first glance, this deadline doesn't seem too onerous," Horsford said. "In Nevada, my constituents, retail investors often make their investments through intermediaries such as 401k plans and other retirement accounts.... [They] would need to submit their orders to their intermediary hours beforehand, potentially as early as noon... [They] would miss out on today's price if they can't get their trades in by 9 a.m. Pacific Standard Time... What would you say to investors who worry that a hard close would lead to a bifurcated market, where sophisticated investors will be able to utilize more information and lock in the day's price while others are forced to trade early in the morning? Do you see ways to mitigate this disadvantage for West Coast investors while still implementing a swing pricing proposal?"

Gensler told him, "We have a system right now [in which] open-end funds and money market funds work really well for [your constituents] during normal times, but in times of stress… we've had to rely on our Federal Reserve and other means to… support them from time to time: the 2008 crisis and 2020, and so forth. We're trying to find a way that those funds are less reliant on potential extraordinary measures from our central bank. So there's a bit of plumbing, a bit of infrastructure behind the scenes, when you and I think we're putting in an order by 4 pm Eastern Time, or 1 pm Nevada time, that it's actually going to a retirement plan servicer and then they're sending it, and we're trying to address [that]… This also adds to the challenge of the systemic risk issue, that those fund managers may currently not know until late that evening or even the next morning what redemption requests they have."

Daniel Meuser (R-PA) then asked if the SEC had gone to the Department of Labor to do a study on the effect of the being pricing rule on retirement plans. Gensler said he had not. Meuser asked him to consider it. Zach Nunn (R-IA) also asked about the swing pricing proposal and its effect on small businesses. Gensler told him, "We're trying to address the systemic risk in our financial system right now. The open-end bond fund community has called upon the Federal Reserve for assistance in time of stress."

Banks' Custody of Digital Assets. Mike Flood (R-NE) brought up the SEC's Staff Accounting Bulletin (SAB) 121, which relates to banks' custody of digital assets, asking if Gensler had conferred with any of the prudential banking regulators before issuing the proposal. Gensler said, "Putting crypto assets off the balance sheet is also a recipe for further risk in the system and disaster for the system.... Under the authorities Congress gave us, our chief accountant is the chief accountant to look at what public companies' questions are, and they consulted with Big Four [accounting firms], they consulted internally, and put out that staff accounting bulletin." When Flood asked what feedback the SEC had received from regulators after the bulletin was issued, Gensler said, "Just as has happened in the past, they have their own authority to take up what regulatory actions they will take, but we address just public company accounting. And today, in the U.S., there's no good regime -- once you take a crypto asset, a company, there's no segregation, and until that's resolved and protected, it will be very different from taking custody of equities… Congress gave one agency oversight over public company accounting, and that's the SEC."

Disclosure of Large Swap Positions. Rep. Lucas said there is a consensus among market participants "that the SEC's proposal to publicly disseminate large security-based swap positions would deeply harm liquidity, particularly in the credit market. As you know, for example, the CFTC has a large-position reporting regime for futures. But that information is anonymous and aggregated." Lucas said he had sent Gensler a letter in November on the issue. "We specifically asked that you support an approach that requires confidential reporting, noting the potential harm of putting sensitive position information out to the market… Will the SEC amend the proposal to reflect this bipartisan feedback?" Gensler said he remembered Lucas' letter and the Commission is considering it. "Part of the motivation for Congress putting this into the Act that you helped write was not only for the official sector to have some confidential information, but also for some of that information to be in the public domain, and that's what we're sorting through," he said.

Debt Ceiling. Asked about the possible effects of failing to raise the nation's borrowing limit, Gensler warned there would be less liquidity in markets that could raise the cost of borrowing and infect the banking sector. "If we were to get close to that state…it is likely that we would start to see fraying– less liquidity in the Treasury markets, which ultimately means higher cost to the taxpayers," he said. "If we were to go over that default cliff… It would be one heck of a mess of capital markets. It would hurt the equity markets, the rest of the fixed-income markets, and it would ripple into the banking system."

Executive Compensation. Nydia Velázquez (D-NY) asked what the SEC is doing to address excessive executive compensation at public companies in the wake of the Dodd-Frank Act, whose provisions on clawbacks of compensation to certain executives still have not been completed. Gensler said the SEC currently requires executive compensation to be clawed back if the amount was based on inflated financial performance, and the agency last year adopted pay-versus-performance reporting disclosure.

Staff Turnover at SEC. Republicans faulted Gensler for staff turnover at the agency, asking him if the SEC had the resources to properly draft new rules and enforce existing rules. Gensler said the agency has an attrition rate between 6 percent and 7 percent, on a par with other government agencies.

Legislation to Restructure SEC. Warren Davidson (R-OH) told Gensler that his "record of failures to protect investors and abuses of power make it clear that we need to restructure the Securities and Exchange Commission." He continued, "The failures are many, but let me cite some of the abuses. You average more than two rules proposals a month; you provide inappropriately short comment periods. You have unworkable and unlawful ESG [environmental, social and governance] disclosure mandates on the market. You have essentially a 'Hotel California' rule for crypto when 'you can check in anytime you like, but you can never leave.' You have endless discovery with no resolution and no clarity for the captives in the market. You have unworkable proposals for overhauling equity market structure, a *de facto* ban on crypto through the proposed custody rule. You have high staff turnover, unhappy people leaving your office, and unhappy companies and capital leaving our country… I am introducing legislation that removes the chairman of the Securities and Exchange Commission and replaces the role with an executive director that reports to the board, where all authority would reside."

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