A recent program presented by BakerHostetler, entitled “100 Days In: What Hedge Funds Can Expect From Congress, the SEC and the Trump Administration,” provided timely insight on how the SEC and its enforcement priorities may evolve under the new president’s regulatory agenda, as well as how the new administration may affect the markets in general and private funds in particular. For another look at Trump’s potential effect on the fund industry, see “Ways the Trump Administration’s Policies May Affect Private Fund Advisers” (Mar. 2, 2017).

Mark A. Kornfeld, partner at BakerHostetler, moderated the discussion, which featured former SEC Commissioner Troy A. Paredes, founder of Paredes Strategies LLC; Marie Noble, partner, general counsel and chief compliance officer at SkyBridge Capital; and BakerHostetler senior adviser Hon. Michael A. Ferguson and partner Marc D. Powers. This article summarizes the portions of the presentation most relevant to hedge fund managers.


Potential Changes at the SEC

As Jay Clayton has been confirmed by the U.S. Senate as the new Chair of the SEC, he will be able to select the leaders of the SEC’s Office of Compliance Inspections and Examinations as well as the agency’s five divisions. The SEC and other government agencies are not monolithic entities, Paredes remarked; they are “a bunch of people, and different people will do different things,” even if they share political inclinations or party affiliations. Therefore, it is important to look at the individuals who are selected for each of those positions.

The SEC has been operating with just two of five Commissioners: acting Chair Michael S. Piwowar and Kara M. Stein. President Trump nominated Clayton to be the new Chair, but there is no indication as to how the two other vacancies will be filled. “There are lots of complexities, not just at the level of senior staff . . . but at the level of the Commission itself;” Paredes said, characterizing the situation as a “big question mark.”

An increasing focus on economic growth could affect the SEC’s posture on both public and private offerings, Paredes noted. The SEC has twin goals: to facilitate capital formation and to protect investors. Although the traditional perspective is that those goals conflict, there is now some sentiment that reforming regulations to make it easier for companies to raise capital may actually be good for investors.

The big question, in Paredes’ view, is whether the SEC is going to be “a chaos organization or . . . a macroeconomic-policy-capital-formation organization.” Regardless of the political affiliations of its Commissioners and staff, the SEC will continue to focus on the dual goals of capital formation and investor protection. Those people take the agency’s independence very seriously and will try to protect that independence. See “Acting SEC Chair Emphasizes Agency Will Protect the ‘Forgotten Investor’” (Mar. 2, 2017).
For more on potential regulatory reform and regulatory uncertainty, see “Ten Key Risks Facing Private Fund Managers in 2017” (Apr. 6, 2017); and “How the Trump Administration’s Core Principles for Financial Regulation May Benefit the U.S. Funds Industry (Part One of Two)” (Feb. 16, 2017).

**SEC Enforcement Philosophy**

Clayton is a “great choice” for SEC Chair because he has “Wall-Street spirit,” said Powers. Former Chair Mary Jo White’s background as a prosecutor led to an emphasis on accountability and enforcement actions at the SEC. White recently called the SEC a “civil enforcement agency,” he added, even though enforcement is only one of its five divisions. Powers expressed hope that the new Chair’s priorities will be consistent with those of President Trump, with a focus on capital formation and growth.

It had become too easy for SEC staff to commence investigations, in Powers’ view. For the past several years, certain senior enforcement staff had the authority to issue subpoenas and formal orders of investigation. Previously, staff that believed a violation had occurred would have to send an “action memo” to the Commissioners, who would need to approve the order of investigation by vote. Recently, however, Acting Chair Piwowar has reportedly curtailed certain of those powers.

Even with the centralization of enforcement authority, Powers said he expects enforcement to continue vigorously for the next year or two due to matters already in the pipeline. There could be a “rebalancing” after that and a swing of the pendulum in the opposite direction, he opined. At the March conference sponsored by the Securities Industry and Financial Markets Association, representatives from the DOJ, CFTC, SEC, Attorney General’s Office and other regulatory bodies all indicated that there would be no change, said Kornfeld. For a look at the enforcement priorities of the CFTC, see “WilmerHale Attorneys Detail 2016 CFTC Enforcement Actions and Potential Priorities Under Trump Administration” (Feb. 16, 2017).

The SEC can be both “pro-issuer” and “pro-investor,” in Paredes’ view. It is possible that the SEC will now shift emphasis and focus on what it can do to assist capital formation.

Does the fund industry “get to exhale a little bit,” or does it have to remain at “the platinum standard of ‘en garde’?” Kornfeld queried. Compliance should remain “front and center,” Paredes replied. Industry professionals often say to him, “I’m a compliance person. I’m trying really hard to get it right, but I don’t know where the line is. I am not trying to play fast and loose [or] to be cute; I am just trying to understand what the expectations are.” People just want to know clearly what they must do to comply effectively, Paredes continued. One way the SEC could address this is by providing market participants with additional insight as to what is expected. Even if it does not rewrite regulations, the SEC may offer further guidance and certainty, with less “regulation by enforcement.” This is not really a political issue, but it does call for a delicate balance.

Notwithstanding any potential shift in SEC emphasis, SkyBridge is not changing; it will maintain a “top-down” emphasis on being “A+” in compliance and on engaging in appropriate ethical behavior, said Noble. See “Private Fund Managers Should Continue Aggressive Compliance Efforts Despite New Administration” (Apr. 13, 2017).

**Fiduciary Rule**

Without Congressional action, it may not be possible for Trump to eliminate the Department of Labor’s fiduciary rule, Noble noted, but he could potentially “let it die on the vine.” Moreover, some market participants are structuring their operations to avoid becoming subject to the rule. See “Despite the DOL Fiduciary Rule’s Uncertain Future Under the Trump Administration, Managers Should Continue Preparing for Its April 2017 Implementation (Part Two of Two)” (Feb. 23, 2017).
enforcement power is under siege, Kornfeld said. Paredes disputed this, conceding however that the SEC's ability to obtain certain types of relief may be limited, as may its ability to bring certain actions in the first instance.

The SEC has always focused on misconduct and enforcement, Paredes added. SEC priorities will shift over time, even during a Chair's tenure. There will be active enforcement by the SEC, but it will take time to see how the agency's priorities develop under Clayton, Paredes said, as many cases are already in the SEC pipeline.

The SEC's priorities will eventually be shaped by the views of the Commissioners, the outcome of cases like Kokesh and "circumstances on the ground" to which the SEC must react. The SEC is also likely to focus more on data analytics, machine learning, artificial intelligence, understanding the markets, detecting misconduct, conducting examinations and pursuing enforcement. See "Outgoing SEC Chair Outlines New Model for Enforcement Priorities in 2017 and Beyond" (Jan. 12, 2017).

Another possibility is that there could be fewer "novel and unique theories being advanced" by the SEC, Powers added. A more aggressive Chair will require the staff to seek approval before bringing cases under novel theories of law, which were pursued in the SEC's recent campaign against insider trading.

In light of recent challenges to the SEC's authority to bring enforcement proceedings before administrative law judges, a recent decision limiting SEC authority over certain short-sales outside the U.S. and Clayton's investment-side bend, it may appear that the SEC's enforcement power is under siege, Kornfeld said. Paredes disputed this, conceding however that the SEC's ability to obtain certain types of relief may be limited, as may its ability to bring certain actions in the first instance.

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Statute of Limitations for Disgorgement Actions

A general statute of limitations that governs penalty provisions throughout the U.S. Code, 28 U.S.C. § 2462, provides, in relevant part, that “an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued. . . .” The Supreme Court has previously ruled that § 2462 prohibits the SEC from imposing a civil fine for conduct that occurred more than five years ago, Powers explained. It did not matter that the conduct had been hidden and that it took the SEC time to discover it. The decision left open the question of whether the SEC could require disgorgement of ill-gotten gains for past conduct.

The Supreme Court is now considering the applicability of § 2462 to disgorgement in the appeal of the Tenth Circuit’s decision in SEC v. Kokesh, which held that disgorgement is neither a “penalty” nor a “forfeiture” within the meaning of § 2462 and therefore was not subject to the five-year limitation period in § 2462, Powers explained. This is a “huge” issue, because disgorgement is often the biggest part of sanctions imposed by the SEC.

In SEC v. Graham, the Eleventh Circuit reached the opposite conclusion and held that § 2462's statute of limitations applies to disgorgement, so the Court’s decision should now resolve the circuit split. In Powers' view, at the Kokesh oral argument, the justices seemed to sense that disgorgement felt more like “a form of forfeiture” subject to § 2462 and appeared skeptical as to the SEC’s authority to demand disgorgement in the first place. He predicted that the Supreme Court would hold that disgorgement actions are covered by § 2462.

Funds-Industry Outlook

President Trump's commitment to invest in infrastructure and facilitate repatriation of profits held offshore could be good for the fund industry, Kornfeld noted. On the other hand, his aggressive trade policy and a more isolationist America might not have a positive impact and could harm foreign funds.

From a macroeconomic perspective, “corporate America” would certainly oppose trade wars, which would be anti-growth, Noble noted. She believes that Trump is a “pro-business, pro-growth, pro-jobs president,” and that there is room for consensus on infrastructure spending and tax reform. See “How Tax Reforms...
Proposed by the Trump Administration and House Republicans May Affect Private Fund Managers” (Feb. 9, 2017).

Trump’s recent 4 percent GDP growth target is “overly optimistic,” Nobel said. Under the circumstances, SkyBridge is positioning its portfolio to plan for a “moderate” level of success by Trump. If he moves toward the middle and “gets past the noise,” some things may get done.

“A Whole Different Deal” Under Trump

Trump has “upended” the political and government establishments, changing fundamentally the way the White House operates, said former Congressman Ferguson. It is “a whole different deal.” Trump “thrive[s] on conflict” and “wants to see people who disagree with one another, who argue, who fight . . . and watch them fight it out.”

There is concern that the “chaos” created by this approach will not be effective, but in Ferguson’s view, if Trump can “break the dam” with healthcare and tax reforms, other reforms will be easier to achieve. Along that vein, Noble believes that if Trump is able to fulfill some of his campaign promises on infrastructure, deregulation and tax reform, the economy will benefit.

Trump is a “non-ideological president . . . [and] barely a Republican,” Ferguson quipped. He appears more interested in bilateral trade deals than multilateral deals and may find it easier to pursue a more activist foreign policy than an aggressive domestic agenda.

It appears that it is going to take much longer to get certain things done than Trump and his team anticipated, Kornfeld added. Given the setbacks on healthcare and other domestic initiatives, along with the troubles with nations including Syria, Russia and North Korea, Kornfeld queried whether Trump will shift to being a foreign-policy president. Many nations are testing Trump, Ferguson noted. Even so, there are certainly some big domestic policy issues he wants to take on, because he will eventually be graded on healthcare, tax reform, infrastructure, immigration and job creation. He added he would not be surprised if both healthcare and tax reforms are accomplished.