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7 Massive Challenges Facing the New SEC Chief

By: KATHERINE REYNOLDS LEWIS - November 28, 2012

With Securities and Exchange Commission Chairman Mary L. Schapiro set to leave the agency Dec. 14, her successor, Elisse Walter, inherits a swollen to-do list. The agency still must implement most of the reforms mandated under the Dodd-Frank Act, in addition to addressingand deal with other pressing issues identified by both Schapiro and Walter identified as concerns, such as high-frequency trading and money market fund regulation.

When Schapiro became the first woman to helm the securities regulator in 2009, she took over a commission badly battered by the financial crisis and collapse of Lehman Brothers, not to mention Bernard L. Madoff's multi-billion-dollar Ponzi scheme. Some commentators have called it the lowest point in the SEC's history.

In the immediate aftermath of the financial crisis, some in the Obama administration and on Capitol Hill called for the elimination of the SEC and a merger with the Commodity Futures Trading Commission. Schapiro managed to protect the agency's autonomy during Dodd-Frank negotiations and even received a budget increase to carry out the new regulatory mandate from Congress: nearly 100 new, separate rules to set.

"Given the fact that the SEC went into the Dodd-Frank process with a tattered reputation, they came out of it with more power and authority," said Mark Calabria, director of financial regulation studies at the libertarian Cato Institute. "It's not like she's leaving her successor a clean plate, but that might be an unrealistic expectation at the end of the day."

Walter is that successor, if only for the time being. She can legally serve as chairman without needing Senate confirmation until either a new chairman is nominated and confirmed or Congress adjourns in 2013, usually November or December. Here are the seven looming challenges she'll grapple with in her new role, according to Calabria and other financial regulatory experts.

Leading a split commission. After Schapiro leaves the SEC, two Democratic and two Republican commissioners will remain. That means an end to the 3-to-2 votes that Schapiro managed to push through on issues such as conflict mineral disclosure, audit trails, short sales and fund adviser registration.

"The biggest concern for the agency is that they won't have a working majority," Calabria said. "You certainly can get votes done but it means Walter has to work across the aisle."

Moreover, if Walter aims to remain on the commission in a fresh term as chairman, she must tread lightly to avoid antagonizing lawmakers who would vote on her nomination.

Harmonizing, or cutting through, a chaotic jumble of rules. In addition to the 95 rulemakings mandated by Dodd-Frank – only a third of which have been finalized – the SEC must routinely review and enforce its existing body of regulations. Meanwhile, the banking and derivatives regulators have their own set of rules that may conflict with the SEC's, subjecting different institutions to different requirements when they carry out the same activities.

"It is really striking how chaotic the framework is," said Karen Shaw Petrou, managing partner of Federal Financial Analytics, which recently conducted a study of unintended consequences from the regulatory overhaul. "These are hard issues and they're often being addressed in silos.... That's a key leadership goal: To make the rules make better sense."

Regulating money market funds. One of the top priorities for Schapiro was imposing new rules on money market funds, implicated by many observers in the financial crisis. This summer she failed to win support from a majority of commissioners for an SEC proposal, and instead punted the issue to the Financial Stability Oversight Council, which released a series of money market proposals for public comment. It remains to be seen whether Walter, a longtime ally of Schapiro, will defer to the FSOC or attempt to take the lead on the issue.

Writing rules for proprietary trading. One of the most contentious issues in the Dodd-Frank debate was the so-called Volcker Rule to ban banks from proprietary trading. The SEC is working with the banking regulators and the CFTC to craft a regulation that will stop banks from placing market bets with their own money. Advocates say the rule, named after former Federal Reserve Chairman Paul Volcker, would have limited the impact and spread of the financial crisis. Critics, particularly on Wall Street, contend that the rule would result in higher costs for companies and investors without effectively eliminating financial risks.

Improving oversight of high-frequency trading. The increase in computerized and automated trading, which exacerbated the 2010 flash crash, prompted criticism that the SEC hasn't done enough to rein in high-frequency traders. "For the public in general, the flash crash has faded from memory, but I don’t think it's faded from the SEC thinking they should do something," Calabria said.

Dealing with blowback from courts. In another setback under Schapiro, a federal court overturned an SEC "proxy access" rule that would have given shareholders more power to nominate directors for the boards of publicly traded companies, blasting the agency for failing to adequately consider the cost-benefit tradeoffs. The agency has also faced criticism from a federal judge over its Citigroup settlement.

Implementing the JOBS Act. The new law gives startups with annual revenue under $1 billion an easier path to an initial public offering, by allowing confidential SEC filings and meetings before an IPO. Schapiro had expressed concern about the legislation eroding investor protections.