U.S. Securities Regulation Past, Present, and Future: A Discussion with Former SEC Commissioner Rob Jackson

Should the U.S. move to adopt global accounting standards?

What reforms might be needed for corporate stock-granting and director reelection?

How might greater competition improve U.S. stock exchange dynamics?

On March 6, 2020, Rob Jackson, former Commissioner of the U.S. Securities and Exchange Commission (SEC), answered those and other questions for an at-capacity audience of faculty, students, and others at the Kellogg Global Hub—just weeks after completing his term in the role.

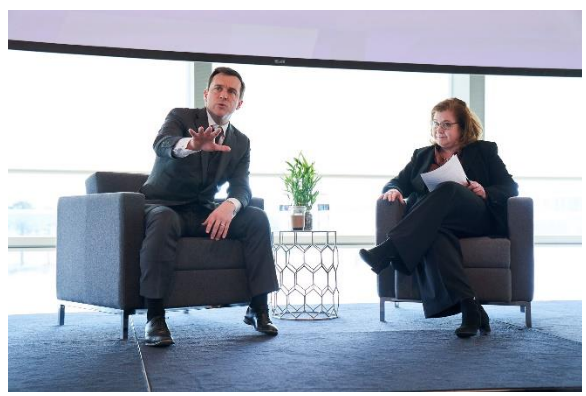
He was introduced by Professor Ben Harris, Executive Director of the Kellogg Public-Private Initiative. Professor Jan Eberly, James R. and Helen D. Russell Professor of Finance and former Chief Economist of the U.S. Treasury, moderated the conversation and Q&A with Jackson, who now works as an NYU law professor.

The SEC formed in the wake of the Great Depression, and plays a critical role in regulating securities markets today. "The commission has deep influence on markets and careers," Jackson says.

He discussed his path to the SEC, along with a range of issues and challenges related to U.S. finance and regulation.

The Path to the SEC

Jackson's original path was unlikely to lead to the SEC.



"In business school I was on a finance track," Jackson says. "I wound up at [investment bank] Bear Stearns, where I worked on IPOs. I saw lawyers as expensive and in my way, but eventually realized that was wrong: in a post-financial crisis world, business decisions would have policy influence and vice-versa. I realized how exciting that work was."

"I get angry when I don't understand something," he continues. "Like with a doctor or mechanic. I want an explanation. On Wall Street there were lots of legal questions I couldn't answer. So I went to law school. When I got there I saw how policy decisions were made without understanding of finance. So I took a job at the Treasury." At the U.S. Treasury, Jackson advised on the country's recovery from the Great Recession.

His early family experience fueled his focus on protecting financial markets: "After my birth my parents put $20 a week in the stock market, knowing it could change the family's future. So it's about putting investors first, and protecting the ordinary American who wants to change their future."

Ultimately, Jackson found his way to the SEC, becoming Commissioner in January 2018.

"I'm a risk-taker because I believe I'm playing with house money," he says of his career path. "I was crossing my fingers just to go to college, then studied finance to avoid being poor. I'd work on policy for free. We're lucky that in this country you can get policymakers to consider your ideas."

The Challenge of Boards and Exchanges

Jackson discussed tricky issues related to U.S. corporate boards and stock exchanges.

One board-related challenge is that the issuing of dual-class shares of stock provides company founders "hammerlock" voting power—enabling them to control board elections and membership.

"This is true at Google, Facebook, Berkshire Hathaway, and many others," Jackson says. The argument is that the founder should be able to pursue their vision without being thrown out prematurely by the board, like what happened with Steve Jobs decades ago. But it shouldn't be forever. Under the current rules, someone like [Facebook founder] Mark Zuckerberg can hand off the company to his heirs. That's called royalty. We need more accountability."

In fact, Jackson believes rules for corporate director reelection need general reform: "They always get reelected. The incumbency effect in public companies is three times as strong as in Congress. The rule should be that major shareholders can put their own candidates on the proxy ballot, but we haven't made that happen."

The stock exchanges represent related challenges. "The exchanges used to be owned by Wall Street," Jackson says. "They used to be regulatory in focus. Now they're private profit-making institutions and act like it—it's not profitable to tell Mark Zuckerberg what to do."

Competition Is Critical

"Many problems in American finance can be cured with robust competition," Jackson says, advocating for implementation of a U.S. Office of Competition.

He points to U.S. stock exchanges as a prime example: "There are 13 stock exchanges nationwide. Twelve of these are owned by two conglomerates. That's anticompetitive, such as when they raise prices on data. We need to be harder on that. If they want to raise data fees, they need to prove that's competitive."

Moreover, the exchanges run the [Securities Information Processor] (SIP) providing free, consolidated exchange-related information including bid-ask quotes and trades. But they charge for the private data feeds they offer. "That's like letting Barnes & Noble run your public library, then being surprised there's no good books at the library!" Jackson says. On his last day at the SEC he proposed a rule allowing others to help run the SIP, to better protect investors.

Still, there's no easy solution, such as simply creating more exchanges. "We want more competition," Jackson says, "but exchanges are difficult and expensive to launch, and have to be high-quality due to cybersecurity threats. Plus the existing exchanges oppose new ones, like what happened with the IEX exchange—it took years to get approved."

Toward More Accessible Private Markets

Jackson also shared thoughts on private-market accessibility.

"Before," he says, "to raise capital you had to go to the stock exchange. Now you can raise $300 million by making a wrong turn in California! A lot of the growth happening in private companies is enjoyed only by wealthy, sophisticated investors. The problem is that the private market is so robust that firms can stay private much longer."

Jackson suggests creating an institutional infrastructure enabling everyday investors to invest in private companies: "That could mean providing people access to private funds that invest in private companies, with lots of investor protections. But we shouldn't relax standards so that individual investors can invest in specific private companies, rather than funds."

Why not? Because, as Jackson notes, large funds would cherry-pick the best private companies, leaving investors with suboptimal choices. "I also don't think individual investors will be good at picking private-company investments," he adds.

A Question of Oversight

Oversight represents an ongoing challenge in U.S. finance.

"Accounting oversight is done in an unusual way here," Jackson says. "Accounting standards are set by nonprofits, but after accounting scandals like Enron, Congress wanted a different kind of oversight."

Out of that motivation grew the Public Company Accounting Oversight Board (PCAOB), overseen by the SEC. This body, too, has proven controversial, as Jackson notes: "Members are chosen in a highly political way, and not seen as enforcing the rules sufficiently. For example, they're supposed to investigate public accounting firms, and need to provide more transparency about what they find." As a step toward improvement, in 2016 the PCAOB introduced a new form (Form AP) requiring disclosure of the audit firm overseeing an audit, and the name of the specific partner involved.

Still, Jackson says people have "lost faith" in the PCAOB. He advocates that the U.S. adopt global IFRS accounting standards, and sees recent progress toward this.

A Major Risk

One of Jackson's largest concerns is corporate cybersecurity.

"It's a 24/7 war," he says. "People can profit from attacking companies with valuable data pools. About 80 percent of companies' balance sheets today is data and information. And there's evidence that people who launch the attacks inform others, so you see trading right before hacks."

"I advocated for a bright-line disclosure rule," Jackson continues. "That means firms must disclose a hack within two weeks. Our data showed that companies chose not to disclose hacks 97% of the time, because it represents bad news. Transparency would help."

The Best Armor

In closing, Jackson offers investors advice on protecting themselves.

"The answers won't come from Washington," he says. "No one can oversee everything. The SEC has the Office of Investor Protection, and I'd expand it many times if I could. But there are millions of investors everywhere. It's hard to break through the noise. So the best armor is deep education, and healthy skepticism about investment advice. People need to make better-educated decisions, whether it's about checking the box for their 401K or knowing what broker to sign up with."