Full Disclosure

Since taking the helm at the Securities and Exchange Commission, ***Gary Gensler*** *has initiated a wide-ranging set of rules, including landmark Treasury market reforms. A commitment to transparency lies at the heart of the agency's mission, he tells* **IQ**

IQ: You're now well into your fourth year as chair of the US Securities and Exchange Commission (SEC) and it's been a very busy time for rulemaking at the commission. Which rules do you see as the most significant, and what are the priorities going forward?

Gary Gensler (GG): One of the privileges of leading this agency is working with the 5,000 people here, but it's also the breadth of the issues in which we're involved. We've already proposed and adopted more than 40 items during my time here. More than three quarters of those are well into the implementation phase and have not been challenged in court.

We recently halved the US settlement cycle for equities and corporate and municipal bonds, along with Canada and Mexico. This is a key investor protection initiative where we're really leading the globe – you sell your stock on a Monday; you get your cash on a Tuesday. It's straightforward stuff but pretty important. Europe, Switzerland and the UK are now looking at how they might join us in the next few years.

We've adopted and implemented some really critical items related to corporate governance, including how executives can sell their shares in the market and how they publicly disclose their pay versus performance. This is all very consequential for strong corporate governance.

We've taken some very important steps in cyber, both for companies and issuers that have material cyber events and, more recently, for individuals. So, if your broker-dealer or investment adviser has a hack and your personal identifying information is taken, you would get a notice.

We've adopted and are working with clearing houses and market participants

on implementation of some key reforms in the Treasury market related to central clearing. This is really critical in the $27 trillion Treasury market, which has seen repeated jitters. Bringing more volume into central clearing will help to promote all-to-all trading in these markets.

We've addressed some of the repeated instabilities in money market funds and adopted rules last year that are still being implemented. We adopted rules on truth in advertising for registered investment companies and we have updated a 24-year-old rule in that area. I'm very proud of some of the work we've done regarding issuers in the US market from China, making sure we have proper access to inspect their auditors.

It's a wide-ranging policy agenda because this is an agency that covers the full spectrum of capital markets. Those markets are $110 trillion-$120 trillion in size with a diverse set of asset classes, market participants and investors.

IQ: Following a series of market shocks in recent years, global policymakers have been exploring what they perceive as vulnerabilities in non-bank financial intermediation (NBFI) and considering policy measures to address leverage, liquidity, margin and transparency. How has this body of work informed the SEC agenda during your tenure?

GG: The US capital markets have benefitted from vibrant competition between banks and non-banks, which has led to greater competition in capital markets, more access to capital for issuers and more investment choices for savers and investors. Compared to Europe, we're much more reliant on non-banks than banks for credit intermediation – 75%-80% of credit provision in the US is outside of banks and in Europe it's almost the reverse.

That doesn't mean NBFI is without risk. We've taken up a series of resilience projects, including shortening the settlement cycle and the Treasury market reforms. There are three main reforms in that market – central clearing, oversight and registration of dealers and registration of some trading platforms. We've taken up resilience projects on clearing house governance, recovery and wind-down, and several projects relating to mutual funds. We also have proposals outstanding on broker-dealers' cyber resilience policies and procedures.

IQ: The Treasury market reforms that were finalised in December 2023 will require major structural changes, and implementation deadlines are fast approaching. Are you confident there will be sufficient time for implementation? What message would you give to market participants on preparation and implementation?

GG: These are important reforms that have a lot of support in the official sector, but also among market participants. There are key protections that will come into effect from March 2025, starting with customer clearing. These protections mean broker-dealers will no longer be able to net customers' margin against their house money when they're onward posting to the clearing houses, and the clearing houses will have to add protections for customer clearing. That's only nine months away and although there's a fair amount of work to do for the enhanced clearing of the funding market by June 2026 and the cash market by December 2025, it's important to do the work and get involved in the testing and building so that budgets and technology are ready on time.

While there is ample time, there are still going to be issues that market participants will need to work through. The US market shortened the settlement cycle, and we were able to do that 15 months after we adopted the rule. We adopted the Treasury rules in December 2023 – 15 months before customer clearing and another 15 months before funding clearing is due to be implemented. I have confidence in the abilities of market participants and clearing houses to get these important projects done, but it is a team →

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→ effort – it takes planning by all market participants and work on documentation, trade flow and the like.

The net result will lower risk in the system. The US Treasury market has had repeated jitters and fragilities. It's too important a market to leave as it is, with so much risk outside of regulated clearing houses in largely unregulated interdealer brokers acting as central nodes in the system. That model has been shown to be fraught with problems during times of stress.

IQ: How many clearing houses do you think will ultimately clear US Treasury securities? Is there a balance to be struck between competition and netting efficiencies?

GG: By our remit from Congress, we as an agency consider competition to be a good thing. So, if there are other clearing houses that make filings with the SEC, we will consider them under the law and the rules. I won't prejudge any of those potential filings, but competition can lead to efficiencies and better markets. It's critically important that we don't lower risk standards – robust risk standards for clearing houses help to protect the whole market.

IQ: Following approval from the SEC and the Commodity Futures Trading Commission (CFTC), CME and the Fixed Income Clearing Corporation recently enhanced their cross-margining arrangements, increasing the product scope and simplifying the overall calculation process. What positive effects do you anticipate from these changes?

GG: I was honoured to be chairman of the CFTC at a time when some cross-margining applications were submitted. My experience with this is that they can benefit the markets and market participants when posting margin, particularly when positions and risk can be legally netted. At the same time, what's critical is that any clearing house manages its risks and has sufficient margin if one of its members fails to protect all the other members of the clearing house and the system at large. So, it's a balance and it's critical that cross-margining doesn't increase risk and lower the protection of any one clearing house.

IQ: The SEC's proposal on safeguarding advisory client assets has received a lot of attention, and ISDA has raised concerns over its application to derivatives. In particular, the proposal would appear to conflict with existing CFTC regulations. Is this something you have been able to discuss with CFTC staff?

GG: A lot has changed since we last updated our custody rule in 2009. We put out for proposal a new safeguarding rule and we got a lot of feedback, which we're still considering. I did ask staff in considering that feedback to make recommendations to the commission as to whether we should seek further public comment or even reconsider the proposal itself. We're still sorting through that and although I don't want to prejudge where the staff might come out, we have received comments regarding custody of derivatives positions. We won't move further on this until the staff is ready.

IQ: In March 2024, the SEC adopted rules to enhance climate-related disclosures by public companies and in public offerings. Will these rules go far enough to provide investors with the information they need on climate-related risk? How important is it to ensure they align with disclosure requirements in other jurisdictions?

GG: Nearly 90% of the top 1,000 US companies by market capitalisation already make some climate risk disclosures to their investors, and nearly 60% already disclose something about greenhouse gas emissions. The new rule is about disclosures to those investors making decisions – it's about materiality and what a reasonable investor would find important when making an investment decision. We're not a climate regulator or an environmental regulator – we are a securities regulator. It's all grounded in materiality as well, so there is a substantial likelihood that a reasonable investor would find it significant in the total mix of

information used to make an investment decision. I'm aware of initiatives in other jurisdictions, but we're sticking to US law and US markets. I look at this only through the lens of the material information investors use to make their investment decisions.

IQ: There has been an active debate about the regulation of crypto assets, and whether they should be considered as securities. What is the appropriate model of regulation for this market?

GG: Without prejudging any one asset, it's pretty straightforward: most crypto assets are likely to be securities and should be regulated as such. There are 15,000-20,000 tokens and there's nothing incompatible about the accounting ledger they're stored on with the securities laws. The principle is consistent – it's about making proper disclosure to investors so they can decide whether they want to buy or sell a particular crypto asset.

IQ: In July 2023, the SEC proposed rules to require broker-dealers and investment advisers to take steps to address conflicts of interest associated with the use of predictive data analytics and similar technologies. How are you approaching the rapid development of artificial intelligence (AI)?

GG: I think AI is among the most transformative technologies of our time and I'm speaking well past generative AI. It's already being used in finance to protect customers from fraud, to survey markets and for compliance with anti-money laundering and sanctions regimes. It's used by traders to assess the markets, by investment advisers to set up robo-advising applications and by insurance companies for claims processing. It's used by all sorts of financial institutions for opening accounts, and I think it will lead to significant changes in corporate issuance and risks and opportunities in different parts of the economy.

Our role here at the SEC remains consistent – it's all about making sure firms disclose the material information that is needed and that those disclosures are not misleading. Just as in other areas of transition, sometimes folks will exaggerate what they're doing with this new technology, whether it's an investment adviser bragging about the use of AI when they're not really using it or a company that says it's doing something but it's not true. We need to beware of misleading the public in any material way – so-called AI washing.

Fraud is fraud and bad actors will try to use new technologies to do bad things. That's been true since antiquity. If firms are using an AI model, they shouldn't think they can now do a bad thing and blame it on the model. If you deploy the model, you have a certain responsibility and obligation, particularly if you're a fiduciary or advising people. If you're using a model to front run or manipulate a market or perpetrate a fraud, there's still a human somewhere who is responsible.

Finally, we have a proposal outstanding about potential conflicts. If you're using an algorithm that's putting the investment adviser or the broker-dealer into the mix of your engagement with customers, the basic concept in the US is that you've got to put the investor first. You must make sure the algorithm hasn't got it the other way around by putting the investment adviser or broker-dealer first.

Those are our three areas of focus – AI washing, fraud and deception, and conflicts. But I also think there's a risk that goes well beyond the US, which is that the use of AI will lead to certain fragilities in capital markets. That is why both the models and the data are likely to end up being quite centralised. We already have a system in the US where there are three large cloud providers, two of which are used by around 75% of the financial sector. There are natural economics of networks that are at play, and that is likely to also happen with AI. If everyone relies on the same model or the same data set, this could drive the market to a bad place, but that's a challenge we all share.

IQ: It's just over a decade since you completed your five-year stint as chair of the CFTC. Of course, 2009-2014 was a very different time, but what similarities and differences would you observe between your time at the helm of these two agencies?

GG: Both are great agencies, tracing their heritage back to the Roosevelt era and protecting the public against some of the abuses and problems of the 1920s. Both benefit from a commission structure that I endorse, bringing together folks from diverse policy and career backgrounds. Both exercise oversight of their markets through exams, enforcement and rulemaking.

But there are definitely some differences as well. The SEC is about nine times larger in terms of staff and flow. Unlike the CFTC, we're very much a disclosure-based agency at the SEC, which is something I'm very proud of. President Roosevelt had a vision of full, fair and truthful disclosures to help investors decide what investments they make. I worked with a great team at the CFTC and now have the opportunity and privilege to work with the 5,000 people at the SEC.

Of course, the CFTC also had the distinction of having Scott O'Malia as a commissioner and although we didn't always agree, when we disagreed, we always found a pathway to do so agreeably. IQ

GARY GENSLER IN BRIEF

Sworn in as chair of the US Securities and Exchange Commission (SEC):
April 17, 2021

Chairman of the US Commodity Futures Trading Commission:
May 26, 2009 – January 3, 2014

Last holiday?
At the beach.

Favourite place to be?
With my daughters – wherever they are.

What keeps you awake at night?
Not much.

Career highlight?
It's the remarkably talented professionals with whom I worked, whether at Goldman Sachs or now at the SEC and in between at the Massachusetts Institute of Technology and on political campaigns.