

# SEC Enters Election Year Focused on Key Initiatives

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As Chairman Jay Clayton's tenure at the Securities and Exchange Commission (SEC) likely enters its final year — regardless of the outcome of the next presidential election — the SEC remains focused on priorities such as protecting the long-term interests of Main Street investors and responding to technological developments that affect how capital markets behave. Chairman Clayton indicated in recent congressional testimony that, to help achieve those goals, the SEC added approximately 140 new employees in the past year, after lifting the hiring freeze that had been in place since late 2016 due to budget constraints.

The SEC welcomed its newest commissioner in 2019, Allison Herren Lee. Commissioner Lee previously spent more than a decade in different roles at the SEC, including as senior counsel in the Enforcement Division's Complex Financial Instruments Unit. Lee, a Democrat, has publicly expressed opposition to certain high-profile proposals taken up by the Commission in the past year, including those that would expand the definition of "accredited investor" and amend the proxy voting regime. Commissioner Lee's appointment filled the only vacant seat on the Commission; however, Commissioner Robert Jackson, the other Democratic commissioner, recently announced his intention to leave the SEC.

Beyond changes in leadership, the SEC has faced heightened scrutiny from Congress and the press over its handling of personnel matters at the Public Company Accounting Oversight Board (PCAOB). Critics argue that prolonged vacancies in senior staff positions at the PCAOB are contributing to low morale and a decline in productivity. These critics, who believe the PCAOB should be nonpartisan, also take issue with Chairman Clayton's recent decision to install officials perceived to be administration-friendly in top PCAOB positions. In light of these concerns, members of Congress and others have called for greater transparency into the board's dealings.

As is customary in election years, activity at the SEC is expected to slow as the general election nears. Thus, the SEC faces a truncated timeline for accomplishing its 2020 goals. Observers expect a heightened level of activity in the first part of the year as Chairman Clayton seeks to shape his legacy and certain high-profile proposals become ripe for consideration.

## Regulatory Modernization

The SEC has taken a number of steps recently to modernize its regulatory framework and likely will continue this focus in 2020. Chairman Clayton has acknowledged that the dynamic nature of securities markets — including changes in investor behavior and advances in communications technology — requires the SEC to regularly take a fresh look at its rules and regulations in order to align them with current market realities.

In 2019, the SEC adopted rules to modernize and simplify certain of its key annual disclosure requirements and to tweak its auditor independence rules to clarify lending relationships with audit clients that could impact independence. The SEC also adopted a rule to allow any issuer (not only emerging growth companies) to use "testing-the-waters" communications with qualified institutional buyers and institutional accredited investors for the purpose of evaluating the viability of a contemplated

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registered public offering before the filing of a registration statement. Further, the SEC adopted Regulation Best Interest to prohibit broker-dealers from putting their own financial interests first when recommending an investment strategy or securities transaction.

**Regulating proxy advisers.** In response to concerns raised about the lack of oversight of proxy advisory firms, the SEC issued an interpretation in August 2019 clarifying that it believes the meaning of “solicit” in the U.S. proxy rules covers the activities of entities that make proxy voting recommendations to institutional investors. As a result of this interpretation, the SEC publicly weighed in on the debate as to whether proxy advisory firms are subject to liability under the U.S. proxy rules. The leading proxy advisory firm, Institutional Shareholder Services (ISS), challenged this interpretation in a lawsuit alleging that the SEC exceeded its statutory authority and failed to satisfy notice-and-comment procedures required by the Administrative Procedure Act. The case is pending before Judge Amit Mehta in the U.S. District Court for the District of Columbia.

Meanwhile, the SEC proposed changes to its rules in November 2019 that would, among other things, codify its solicitation interpretation into the proxy rules, require proxy advisory firms to provide specific disclosures of material conflicts of interest when rendering proxy voting advice, and give companies the opportunity to review recommendations and provide feedback to advisory firms before the firms disseminate the advice. Despite the fact that these proposals, which have been under consideration for decades, set off a fierce public debate, the SEC likely will attempt to finalize the rules before the end of 2020.

**Shareholder proposal process.** The SEC also recommended changes to its shareholder proposal rules in November 2019 that it is likely to adopt before Chairman Clayton departs. These proposals, like

those regulating proxy advisers, were under consideration for some time, and although the changes were fairly limited in scope, they were met with pushback from certain institutional investors and investor advocates, such as the AFL-CIO and the Council of Institutional Investors. Specifically, the proposed changes would, among others things, replace the current ownership requirements to make a shareholder proposal with a tiered approach that combines the number of shares owned and the length of ownership, raise the levels of support that a proposal must receive to be resubmitted at future shareholder meetings and add a new provision that would allow companies to exclude resubmitted proposals that have experienced declining shareholder support.

#### **Participation in private capital markets.**

In December 2019, the SEC proposed amendments to its definition of “accredited investor,” *i.e.*, a subset of investors who meet certain criteria, such as net worth or annual income thresholds, and may participate in private securities transactions. The proposals would, among other changes, add new categories of natural persons who may qualify as accredited investors based on certain professional certifications or designations or other credentials, as well as allow family offices and family clients to more easily satisfy the definition. If adopted, the proposals would likely increase the number of investors that are eligible to participate in certain private capital transactions, creating more flexibility for private companies looking to raise capital. It remains to be seen, however, whether the SEC will attempt to adopt these changes in 2020.

#### **Enforcement Priorities**

Despite being limited by a month-long government shutdown that halted most enforcement activity, the SEC’s Enforcement Division brought 862 actions in Fiscal Year (FY) 2019, a 7% increase over FY 2018 totals. The Division’s

priorities for 2020 — continuing its focus on accelerating the pace of investigations, encouraging self-reporting of violations and promoting transparency around how cooperation credit is assessed — seem likely to encourage a similar or even higher number of actions in the year ahead.

An area that will likely continue to drive growth in the number of enforcement actions is the Share Class Selection Disclosure Initiative. The initiative incentivizes investment advisers to self-report any failure to disclose conflicts of interest associated with their selection of fee-paying mutual fund share classes over lower-cost alternatives. In FY 2019, 95 investment advisory firms that chose to self-report in exchange for favorable settlement terms returned more than \$135 million to clients.

The Enforcement Division will seek to continue to accelerate the pace of its investigations in 2020 by encouraging greater cooperation. In FY 2019, the average investigation lasted approximately 24 months before the filing of an enforcement action. The Division maintains that it is striving to reduce that number and points to the 17-month timeline achieved in its investigation of PPG Industries, Inc. as an example of how extensive cooperation can shorten an investigation. To that end, the Division is considering ways to provide greater transparency into how it weighs cooperation credit so that more companies are willing to follow PPG’s lead.

The Enforcement Division also is likely to carry its recent focus on accounting and disclosure cases into 2020. In FY 2019, the SEC brought actions against public companies for violations involving deficient disclosure controls, misleading risk factor disclosures, misleading presentation of non-GAAP metrics and false disclosures regarding executive compensation. Notably, the SEC brought a case against Nissan Motor Co., Ltd.

— a company that does not file financial reports in the United States — for filing false financial disclosures obscuring \$140 million that would be paid to the company’s CEO in retirement. The Nissan action could signal a bolder approach toward disclosure violations made by foreign issuers despite some uncertainty surrounding the extent of the SEC’s ability to enforce U.S. securities laws against non-U.S. issuers.

Finally, the SEC will likely pay close attention to Congress and the Supreme Court in 2020 as questions about the scope of its enforcement power are

decided. These questions arise out of the Supreme Court’s 2017 ruling in *Kokesh v. SEC*, which held that the SEC’s authority to seek disgorgement is subject to a five-year statute of limitations. Since *Kokesh*, the SEC estimates that it has foregone an estimated \$1.1 billion in disgorgement. Enforcement authority could be curtailed even further once the Supreme Court hears *Liu v. SEC*, a case set to be argued in March 2020 that challenges the SEC’s authority to seek disgorgement as a remedy. (See “[2019-20 Supreme Court Update](#).”) Though *Kokesh* and *Liu* present challenges to the SEC’s enforcement power, recent bipartisan action on Capitol

Hill suggests that Congress is prepared to step in to protect the SEC’s ability to seek disgorgement and even extend the statute of limitations period for the SEC to obtain disgorgement in enforcement actions.

The SEC is expected to pursue a busy agenda in the first part of 2020, before activity slows in advance of the presidential election. Issuers and regulated entities, therefore, should continue to pay close attention to the ever-shifting regulatory landscape and the SEC’s ongoing efforts to bring actions consistent with its stated enforcement priorities.