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SEC Enforcement Priorities in the Trump Era

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The actions that Securities and Exchange Commission (SEC) Chairman Jay Clayton has taken since the start of his tenure in May 2017 provide an indication of SEC priorities, including encouraging initial public offerings (IPOs) and combating abuses in cybersecurity matters. These and other priorities will have a significant impact on the SEC's regulation and enforcement agendas in 2018.

Initial Steps

A key focus for Chairman Clayton has been filling the top leadership positions at the SEC. He has selected new directors for each of the SEC's major divisions—Corporation Finance, Investment Management, and Trading and Markets—and in the case of the Division of Enforcement, a new co-director. When naming these individuals, Chairman Clayton cited their shared characteristics, including that they are senior professionals with long-standing industry experience, as reasons why this group has the skills to deliver on his goal of re-evaluating the SEC's rules and practice. Additionally, with the December 2017 Senate confirmation of President Trump's commissioner nominees—former congressional aide Hester Peirce (Republican) and New York University School of Law professor Robert Jackson Jr. (Democrat)—the SEC is operating with all five commissioners for the first time since late 2015.

We have already seen the influence of these new leaders on the SEC's priorities. In the Division of Enforcement, for instance, the co-directors have indicated a change to the "broken windows" strategy of bringing enforcement actions based on facts that would generally indicate only minor violations. "It may be the case that we have to be selective and bring a few cases to send a broader message rather than sweep the entire field," newly appointed Co-Director Steven Peikin commented at a securities conference in October 2017 regarding the change. (See Agencies Indicate Efficient, Targeted Enforcement Priorities That Rely on Self-Disclosure.) There also is speculation that the agency may no longer seek admissions of wrongdoing as a condition for settlement, as has been recent agency practice in select cases. Under the prior leadership, the SEC had insisted on admissions to settle a discrete number of matters where the SEC believed that the significance of the case warranted an admission, or where a parallel criminal proceeding included an acknowledgment of wrongdoing.

In the Division of Corporation Finance, the staff has issued new guidance that significantly streamlined the confidential submission process for companies conducting IPOs and effectively eliminated requirements for these companies to provide certain interim period financial statements in initial draft registration statements.

This guidance was well received by the market and reflected a clear goal of Chairman Clayton—encouraging IPOs and easing regulatory burdens on capital formation, regardless of whether the company qualified as an emerging growth company. The Corporation Finance staff also provided welcomed guidance on the new pay ratio disclosure requirements and on the review of no-action requests to exclude shareholder proposals, which has the potential to significantly impact the historical abuse of the process.

Expected Regulatory Changes

In addition to SEC staff actions, Chairman Clayton has streamlined the SEC's rulemaking agenda to provide transparency on what he believes the SEC can reasonably accomplish in the near term. What remains unclear is what matters will advance the new agenda. Most observers expected the SEC to take immediate steps under new leadership to repeal many of the rules adopted pursuant to the Dodd-Frank Act. To date, that has not happened. Indeed, after much speculation that the SEC would either repeal or delay the requirement for companies to disclose the CEO-to-median-employee pay ratio beginning in 2018, the SEC has allowed the rule to go into effect. The SEC also approved the Public Company Accounting Oversight Board's new model for auditor reports that accompany audited financial statements in SEC filings. The new model requires a number of highly controversial new disclosures, including the auditor's tenure with the company and critical matters that he or she focused on during the audit.

The only material rulemaking matter that the SEC has considered under its new leadership, other than some technical rule amendments, is a proposal to modernize and simplify certain disclosure items in its rules and forms. The items proposed to be amended include the number of years required to be covered in the management's discussion and analysis of the company's financial statements and which material contracts must be filed as exhibits to filings made with the SEC.

These rule changes would be welcomed if the SEC was to eventually adopt them, but they would not have a significant impact on company disclosure requirements. It is possible that the SEC's near-term regulatory agenda will be dominated by such amendments. Chairman Clayton noted at the Economic Club of New York in July 2017 that "[i]ncremental regulatory changes may not seem individually significant, but, in the aggregate, they can dramatically affect the markets."

In the meantime, the hope that many market participants had at the beginning of 2017 that Congress would repeal much of the Dodd-Frank Act has faded. Although the House of Representatives passed the Financial Choice Act in July 2017—which would significantly alter the regulatory framework that has been in place since the financial crisis, including a number of SEC reporting and disclosure requirements—the Senate has not taken up the measure in any concerted way. It remains unlikely that the House bill will be adopted in its entirety, but certain provisions and other requests for changes to the SEC rules could become law and would significantly impact SEC rules and practices.

Enforcement Priorities

Many observers also expected to see an immediate and significant decline in the number of SEC enforcement actions as a result of the change in leadership. But the drop in enforcement actions was more modest than expected. According to the SEC Division of Enforcement's annual report, in fiscal year 2017 (which included the last three months of the Obama administration and the first nine months of the Trump administration), the SEC brought 754 enforcement actions, returned approximately $1 billion to investors and obtained orders for approximately $3.8 billion in disgorgement and penalties. Excluding actions brought as part of the SEC's Municipalities Continuing Disclosure Cooperation Initiative, a voluntary self-reporting program that concluded in 2016, the number of enforcement actions brought in fiscal year 2017 declined only 3.8 percent.

In his recent remarks before the Economic Club of New York, Chairman Clayton noted that he "fully intend[s] to continue deploying significant resources to root out fraud and shady practices in the markets, particularly in areas where Main Street investors are most exposed." With regard to more sophisticated market participants, he promised that "the Commission will continue to use its enforcement and examination authority to support market integrity," notwithstanding the agency's move away from a "broken windows" enforcement strategy. In addition, Chairman Clayton and members of the SEC staff have made public statements about their intent to remain focused on the recent increase in bitcoin-related offerings.

The SEC enforcement directors recently identified five core principles that they said will guide the agency's enforcement priorities. They focus on:

- Main Street investors;
- individual accountability;
- keeping pace with technological change;
- imposing sanctions that most effectively further enforcement goals; and
- constantly assessing the allocation of SEC resources.

It is not clear at this point how these principles will impact the number and type of matters that will gain the attention of the SEC's enforcement staff in 2018. One area of certainty is the SEC enforcement lawyers' intent to focus on cybersecurity matters and threats to retail investors, such as inadequately disclosed fees, investment professionals who steer customers to mutual fund share classes with higher fees, and abusive practices such as churning and excessive trading. The staff has already announced the creation of two task forces to combat abuses in these areas. The SEC feels that cyber-related issues are increasing in frequency and significance and that retail investors are among the market's most vulnerable participants.

Although uncertainty persists, in 2018 the SEC is expected to take steps to streamline its rulemaking agenda, even if a repeal of the Dodd-Frank Act or the passage of the Financial Choice Act are each viewed as increasingly unlikely. A slight reduction in the volume of enforcement actions also can be expected, as the enforcement staff focuses its efforts on the agency's recently articulated five core principles.