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Priorities To Shift for Biden's SEC

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With the election of Joe Biden in November 2020 and his subsequent nomination of Gary Gensler as the next Securities and Exchange Commission (SEC) chairman, the SEC's regulatory and enforcement priorities are poised to shift this year.

Clayton Fulfills His Mandate

During his January 2017 speech announcing his plan to nominate Jay Clayton as SEC chairman, then President-elect Trump indicated that he expected the Clayton-led SEC to focus on reducing regulatory burdens. In many respects, Chairman Clayton lived up to these expectations, presiding over a record number of final rulemakings (more than 65), many of which aimed to streamline disclosure rules and reduce "friction points" for both public and private offerings. Some of the final rulemaking highlights from 2020 include: expanding the "accredited investor" definition to allow more Main Street investors to access private markets; amending the proxy rules so that the recommendations of proxy advisory firms generally constitute proxy solicitation; and amending the rules, procedures and ownership thresholds for shareholder proposals.

On the enforcement side, the number of actions filed against public companies hit a six-year low in the federal fiscal year that ended on September 30, 2020, although this is likely due to significant disruptions caused by the COVID-19 pandemic. Despite the decline in cases, the SEC set a new record for money collected through enforcement actions (nearly $4.7 billion), including almost $3.6 billion in disgorgement. Notably, on June 22, 2020, the U.S. Supreme Court preserved the SEC's ability to seek disgorgement, holding that the agency may do so in civil enforcement actions in federal court, but any such amounts are limited to the net profits from the alleged wrongdoing. In addition, on January 1, 2021, the National Defense Authorization Act (NDAA) for fiscal year 2021 was enacted into law. Among other things, the NDAA extends the statute of limitations for the SEC to seek disgorgement for scienter-based securities laws violations, such as insider trading, from five to 10 years.

SEC Priorities for 2021

A number of senior SEC leaders — including Chairman Clayton, William Hinman, director of the Division of Corporation Finance, Steven Peikin and Stephanie Avakian, co-directors of the Division of Enforcement, and Raquel Fox,[1] director of the Office of International Affairs — stepped down before the end of 2020. Other departures from the SEC are likely, as is typical in connection with the end of a presidential term. President Biden's SEC will have the opportunity to significantly shape the SEC's regulatory and enforcement priorities as these vacancies are filled. The following are some issues that the SEC may prioritize in 2021.

Regulatory

ESG Disclosure. Calls for greater environmental, social and governance (ESG) disclosure have grown louder in recent years, and some companies, lawmakers and U.S. exchanges are now responding. For example, in December 2020, Nasdaq filed a proposal with the SEC to amend its listing standards to, among other things, enhance diversity disclosures for Nasdaq-listed companies. Similarly, in November 2020, SEC Commissioner Allison Herren Lee made public remarks arguing that the SEC should adopt a disclosure regime "specifically tailored to ensure that financial institutions produce standardized, comparable and reliable disclosure of their exposure to climate risks." In addition, the Biden campaign published a climate plan that includes "requiring public companies to disclose climate risks and the greenhouse gas emissions in their operations and supply chains," indicating that ESG disclosures — including diversity records and climate risks — are likely to be a high priority for President Biden's SEC. (See "US Corporate Governance: The Ascension of ESG.")

Foreign-Based Issuers. In recent months, companies based in foreign jurisdictions in which the Public Company Accounting Oversight Board cannot inspect audit materials have come under increasing scrutiny. A bipartisan effort by U.S. lawmakers and regulators to require foreign-based issuers to comply with U.S. auditing rules or risk being delisted from U.S. exchanges resulted in the enactment of the Holding Foreign Companies Accountable Act. On December 18, 2020, Chairman Clayton announced that he had asked SEC staff to prepare a unified set of rules and regulations incorporating the terms of the new act. Those are expected sometime this year. (See "Hong Kong's Exchange Improves Its Allure for Chinese Issuers.")

Ultimately, any final rules will be shaped by President Biden's SEC, and the Biden administration may seek a negotiated resolution with individual foreign counterparts instead of pursuing a unilateral approach. Regardless, the focus on and regulatory scrutiny of foreign-based issuers is likely to remain high.

Share Ownership Reporting. Companies and other market participants continue to push the SEC to revise and modernize its share ownership reporting rules. In July 2020, the agency moved to loosen Securities Exchange Act Section 13(f), which requires certain investment managers to disclose their holdings on a quarterly basis. The proposed rules would raise the reporting threshold from $100 million to $3.5 billion worth of securities. If adopted, the change would relieve more than 4,500 investment managers, or 89% of current reporters, of the reporting requirement. The proposal was subject to heavy criticism, with opponents arguing that it would reduce transparency with regard to shareholder bases, allow activist hedge funds to secretly accumulate up to 4.99% of a company's shares and eliminate information on which many stakeholders rely. In October 2020, it was reported that the SEC had scrapped the proposal. President Biden's SEC is likely to examine these and other share ownership reporting rules closely and may ultimately move in the opposite direction by amending the rules to increase disclosure.

Enforcement

Wall Street. During Chairman Clayton's tenure, the SEC concentrated on addressing conduct that specifically harmed Main Street investors. Under the Biden administration, the SEC may refocus its attention more directly on broader Wall Street institutional or market integrity issues. It is not clear, however, how this potential enforcement focus will manifest in enforcement actions.

Insider Trading/Share Repurchases. Although the number of insider trading enforcement actions has trended downward in recent years, President Trump's SEC did bring some notable enforcement actions related to insider trading in fiscal year 2020. In particular, the SEC brought charges against an oil refinery company for allegedly entering into a Rule 10b5-1 share repurchase plan while in possession of material nonpublic information. Ultimately, the matter was settled as an internal accounting controls violation instead of insider trading. The company allegedly used an "abbreviated and informal process" to evaluate the materiality of the nonpublic information it had in its possession, resulting in a decision to proceed with the share repurchases. Although it is unclear whether President Biden's SEC will continue to pursue similar actions on the basis of inadequate internal accounting controls, a continued focus on insider trading matters — a mainstay of SEC activity — is expected.

Disclosure/Disclosure Controls. The SEC has brought a number of cases focused on issuers' risk factors and disclosures in the Management Discussion and Analysis sections of financial statements, as well as some involving other broader disclosure issues. Indeed, issuer reporting and disclosure allegations accounted for 49% of actions brought by the SEC against public companies in fiscal year 2020, according to a Cornerstone Research report. Some highlights include settled enforcement actions against:

- a global conglomerate that allegedly lacked sufficient disclosure controls and procedures and failed to disclose, among other things, that a significant portion of its reported profits came from reducing prior cost estimates;
- a national restaurant chain that allegedly made misleading disclosures concerning COVID-19's impact on its business;
- an energy company that allegedly made misleading disclosures about the status of a $10 billion nuclear power plant project that was eventually abandoned;
- former executives of a multinational financial services company for certifying the accuracy of company disclosures that allegedly contained misleading statements about a key performance indicator for its cross-selling strategy; and
- a high-profile technology company that allegedly failed to disclose certain sales practices that boosted current quarterly sales targets but impacted future sales.

The Enforcement Division's focus on issuer reporting and disclosure is likely to continue under President Biden's SEC.

Takeaways

The SEC's regulatory and enforcement priorities are expected to change under the Biden administration's leadership. These priority changes will likely result in new and revised company disclosure and compliance obligations as well as increased enforcement activity with regard to broader market integrity issues. Companies should stay vigilant and ensure they keep up to date with how the SEC's priorities ultimately unfold under the Biden administration.

[1] Ms. Fox is now a partner at Skadden.