Professional Perspective

Former SEC Officials Predict SEC Priorities

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With the departure of Securities and Exchange Commission Chair Jay Clayton, there will be substantive change to how the Commission under a Biden administration regulates public companies and other market participants in a variety of key areas. With this in mind, in November 2020, Cornerstone Research hosted a panel that provided an outlook on SEC disclosure policies and enforcement. The panel featured former SEC Commissioner Joseph Grundfest and Mary Jo White, former chair of the SEC.

In front of an audience of attorneys and economists, White and Grundfest addressed the urgency that a new SEC chair might assign to various policy and enforcement initiatives. Specifically, they were asked to sort initiatives that the Commission might pursue into tiered priorities: would the initiative be pursued within the chair's first year, within the chair's second or third year, or before the next presidential election, if at all.

Because an agency's direction is driven in no small part by its chair, motivations and initiatives can change dramatically with any new administration. Clayton focused on advancing and protecting the interests of Main Street retail investors. During his tenure, the Commission reportedly "adopt[ed] over 90 rules, many in areas that had not been substantively addressed in decades."

Environmental Disclosures

The panelists were asked to express their views on several policy initiatives in the areas of corporation finance, broker-dealers, and investment advisers. For example, they were asked whether the next SEC chair will prioritize the adoption of new disclosure requirements on environmental, social, and governance (ESG) matters. They were also asked about possible amendments to rules that the SEC has recently adopted, such as Regulation Best Interest, the harmonization of securities offering exemptions, the modernization of the accredited investor definition, and the provision of proxy voting advice, with the goal of either strengthening some parts of these rules or rolling them back.

Among the regulatory initiatives that both White and Grundfest deemed as Tier 1 priorities for the next SEC chair are ESG disclosures. A recent GAO report found that investors are increasingly interested in ESG disclosure and consider the existing ESG information provided by companies lacking in detail, consistency, and comparability. Non-governmental standard setters such as the Sustainability Accounting Standards Board and Global Reporting Initiative are currently leading the way on ESG disclosure.

There have been many requests for the Commission, including most recently from the ESG Subcommittee of the SEC's Asset Management Advisory Committee, to develop a comprehensive standardized framework under which public companies would be required to disclose identified ESG risk factors relating to their operations. Although SEC Commissioners Caroline Crenshaw and Allison Herren Lee, currently Acting Chair, issued a joint statement supporting requirements of additional ESG disclosure, the SEC has so far resisted such requests.

Among the ESG disclosures, the panelists discussed environmental disclosures related to climate-change matters, such as carbon footprint and greenhouse gas emissions, from the standpoint of disclosing both the environmental impact of a company's operations and the risks that the company faces related to environmental issues. During his campaign, President Biden declared that climate change is "the number one issue facing humanity," and has prepared an ambitious plan to tackle the problem. Notably, he has also endorsed requiring public companies "to disclose climate risks and the greenhouse gas emissions in their operations and supply chain."

Moreover, an examination of voting statistics among Russell 3000 companies reveals that climate-related investor concerns are having a meaningful impact on the 2020 proxy season. During the panel, Grundfest stated, "Increased environmental disclosure is about as close to a sure bet as you can imagine. These disclosures would be entirely consistent with the administration's larger policy initiatives, and corporate America's response to these new requirements will, I suspect, depend on the expense involved."

Workforce Composition and Board Diversity

Other ESG matters that the panelists considered were disclosure on the workforce composition to foster a company's commitment to inclusion, diversity, and pay equity, as well as aggregate-level disclosure on board diversity. In 2009, the SEC adopted a rule requiring companies to disclose whether, and if so how, nominating committees consider diversity of board members. If companies have a policy on diversity, they should disclose how its effectiveness is assessed. Because the SEC did not define diversity and left it to companies, companies' definitions of diversity differ greatly in areas such as life and work experience, relevant expertise, and sometimes race, gender, ethnicity, and sexual orientation.

A growing number of company proxy statements have recently started voluntarily providing information to describe the state of the board's diversity composition. During the panel, White stated, "As a GAO study found, companies' disclosures on the diversity of their boards have been inconsistent and often not very meaningful. When I left the Commission in 2017, a proposal to enhance these disclosures was in progress. I would expect the Biden Commission to act to strengthen disclosures in this important area."

Proxy Access Provision Amendments

In September 2020, the SEC amended the shareholder proposal rule by increasing the criteria for eligibility and resubmission of shareholders' proposals in a company's proxy statement. Expected to first apply to any proposal submitted for an annual or special meeting to be held on or after Jan. 1, 2022, the newly adopted SEC rule requires shareholders to demonstrate continuous ownership of at least $2,000 in company securities for at least three years; $15,000 for at least two years; or $25,000 for at least one year. Shareholders cannot aggregate their shares in order to meet the threshold requirements. The previous threshold was $2,000 or 1% for at least one year and allowed for aggregation.

Relatedly, both panelists agreed on the rollback of the proxy voting advice rule as a Tier 2 priority. In July 2020, the SEC adopted amendments to its rules governing proxy solicitations designed to ensure that clients of proxy advisors have reasonable and timely access to information on which to make voting decisions. In the aftermath of this rule amendment, ISS filed a lawsuit in October 2019 alleging that the SEC lacks statutory authority to regulate proxy voting advice. On Nov. 6, 2020, the U.S. Chamber of Commerce and others filed an amicus brief supporting the SEC's authority and rulemaking procedures. Whether this will play out in the courts or will be amended by SEC rulemaking is yet to be seen.

Regulation Best Interest Amendments

A new administration also may want to strengthen another rule that the SEC adopted during Clayton's tenure, Regulation Best Interest (Reg BI), which has enhanced the standard of conduct applicable to broker-dealers when dealing with retail customers. Regardless of whether retail investors choose a broker-dealer or an investment advisor, investors are now entitled to a recommendation that does not place the interests of the firm or the financial professional ahead of the investor. The final rule was voted on by the Commission in June 2019.

The chair of the House Financial Services Committee, Maxine Waters, has reportedly urged President Biden to rescind the rule because it does not go far enough. Both panelists agreed that amendments to the rule might be a Tier 2 or Tier 3 priority because of the complexities involved. Also, as Grundfest observed, "while Regulation BI is a big deal to many market participants, the new chair will have many fish to fry, and many other matters on the agency's agenda will likely be viewed as more important."

Bad Actor Corporate Waivers

In addition to regulatory initiatives, the panel discussion covered some pressing questions on how tough the Commission will be in the exercise of its oversight by tightening, for example, restrictions on bad actor corporate waivers. Currently, the SEC has authority to grant waivers from bad actor disqualification provisions. Waivers have been subject to dissent by particular commissioners in the past. A 2019 discussion draft circulated by Waters proposed new procedures for the SEC to follow when considering waivers, including a notice and comment process. In response to that proposal, Clayton announced a streamlined process for settling entities requesting waivers. White stated, "I would expect the SEC to continue to give these waivers close scrutiny."

Corporate Penalties

Both panelists expect an increase in corporate penalties imposed by the SEC in its enforcement actions. They agreed that the new administration will likely pursue higher corporate penalties as a Tier 1 priority. This expectation would mean an increase in the penalties imposed by the previous administration. In a statement announcing his departure, Clayton highlighted that, during his tenure, the Commission obtained orders for over $14 billion in monetary remedies in enforcement actions and returned a record of approximately $3.5 billion to harmed investors.

For monetary settlement amounts imposed by the SEC on public companies and subsidiaries, a Cornerstone Research study shows that the SEC imposed settlement amounts for a total record-high of $2.4 billion in fiscal year 2018, which was the first full year of Clayton's tenure. The total settlement amounts dropped to $1.5 billion and $1.6 billion in fiscal years 2019 and 2020, respectively.

During the panel, Grundfest stated that "If there is one big takeaway from today's panel, it's that the new chair will likely look at these trends and instruct his staff to do their best to exceed these numbers. The goal will be to bring more enforcement actions and impose larger fines on violators. That will be trumpeted as evidence that the new chair is tougher on Wall Street than the old chair."

Finally, at the end of the panel, Cornerstone Research surveyed the audience on the same policy and enforcement initiatives. When asked to select the top-five priorities, the audience agreed with the panelists that the next chair will most likely endeavor to impose disclosure requirements on environmental risks and board diversity to corporate registrants. Attendants also agreed that enforcement penalties on companies will most likely increase. If these predictions materialize, we can all expect SEC staff to be busy in the next four years.