Securities Regulation Daily Wrap Up, TOP STORY—SEC commissioners, former chairs and ex-CorpFin directors weigh in on future direction of SEC regulations., (Feb. 2, 2021)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

Over the course of a three-day virtual conference hosted by Northwestern Pritzker School of Law, current and former SEC officials opined on a variety of topics, but with special emphasis on ESG disclosure.

Northwestern Pritzker School of Law recently hosted the 48th Annual Securities Regulation Virtual Institute. The event usually takes place in Coronado, CA, but due the COVID-19 pandemic the institute was held online. This year's institute focused on what practitioners can expect in terms of regulatory direction from the SEC under the Biden Administration, including topics like climate change, which is likely to get whole-of-government attention from the Biden Administration. The potential evolution of SEC policy was on display in three panels: (1) current SEC commissioners; (2) former SEC chairs; and (3) former directors of the SEC's Division of Corporation Finance (CorpFin).

Much, but not all, of the discussions involving current and former SEC officials centered on environmental, social and governance (ESG) disclosures. For additional background on the SEC's existing ESG guidance and recent ESG legislative proposals, see the ESG section in the Wolters Kluwer 2020 year-end review of Congress and the Supreme Court (pages 9-17). For more background information on the likely priorities for the Biden Administration's SEC, see the securities and corporate section in the Wolters Kluwer publication Biden inauguration heralds regulatory reset (pages 4-11).

The current commissioners. All four current SEC commissioners participated in a pre-recorded version of the Alan B. Levenson Keynote Address. The keynote address was moderated by Thomas Kim of Gibson, Dunn & Crutcher LLP and Dixie L. Johnson, King & Spalding LLP, the chair and vice chair, respectively, of the 2021 Securities Regulation Institute. At the time of the recording, former SEC Chair Jay Clayton had left the Commission and then-President Trump had designated Elad Roisman to be Acting Chair. After Joe Biden was sworn in as president, he designated Allison Herren Lee as Acting Chair. Commissioners Hester Peirce, Caroline Crenshaw, and Roisman continue to serve as SEC commissioners pending the expiration of their respective terms.

- ***Elad Roisman*—**Moderator Kim asked then-Acting Chair Roisman about proxies. Roisman explained that the recently adopted shareholder proposal rules have a customary phase-in or transition period. Roisman said the long runway is needed because the rules apply to all shareholders, not just the several shareholders who submit the bulk of proposals to companies. With respect to proxy plumbing, Roisman acknowledged that investors think the existing system is not ideal but he said there are no easy fixes and the OBO/NOBO issue remains. According to Roisman, if one designed the proxy system from scratch, it might be very different, but any adjustments to the existing system must focus on transparency, accountability, and confirmability. Kim also asked Roisman about automated voting or "electronification." Roisman replied that this issue is for the next chair to decide, although he said he hopes the SEC will continue to monitor the issue. Roisman explained that he does not care how advisers vote, although advisers must live up to their fiduciary duties to act in their clients' best interest.
- ***Allison Herren Lee*—**Kim also moderated the discussion with Commissioner Lee in which he asked Lee how the SEC can get to a proposal on ESG and climate change disclosures. Lee acknowledged that investors need standardized, reliable information and that issuers need some relief from the onslaught

of demands for more information. Lee said existing frameworks are helpful and that the content of any disclosures could be a mix of principles-based disclosures and ESG metrics. Specifically, she is looking for unified standards and comparability.

- ***Hester Peirce*—**Moderator Johnson first inquired of Peirce regarding digital assets and whether the time had passed for a U.S. regulatory sandbox. Peirce said digital assets are a good case study in how the SEC addresses innovation. Peirce reiterated the need for something along the lines of her proposal for a safe harbor for certain token offerings. Peirce also noted rising international and investor demand for access to non-traditional digital asset assets, such as via exchange-traded funds (ETFs), which she said could provide a more efficient way for investors to access digital asset markets. Johnson followed-up with a question about the seeming increase in the number of dissents to Commission enforcement actions and when it is appropriate to issue a dissent, a topic former SEC Chair Harvey Pitt would comment on in a later panel composed of former SEC chairs, albeit without singling out any particular commissioner. According to Peirce, there is no easy right or wrong answer and the decision to dissent often hinges on the facts and circumstances. Peirce explained that one would not dissent in a litigated enforcement action, but that dissents in administrative actions are appropriate when there is a clear policy disagreement or a legal question is a close call. During the Clayton-era SEC and in the several weeks afterward, the overwhelming majority of separate public statements issued by commissioners concerned policy disagreements at open meetings where regulations were to be proposed or adopted, SEC personnel changes and the passing of former SEC officials, extraordinary market events, and only occasionally enforcement matters. Peirce issued two dissents (Unikrn, Inc. and Great Plains Trust Company, Inc.) and two concurrences (Tradenet Capital Markets Ltd. and Wireline, Inc.); Peirce also issued one joint dissent with Roisman (Andeavor LLC). An equally significant issue for commissioners, especially for chairs, has been whether they may have to recuse themselves from enforcement matters due to conflicts that can arise from their prior law firm or private business work (See, e.g., floor remarks of then-Ranking Member of the Senate Banking Committee Sherrod Brown (D-Ohio)—Brown will be chair of the Banking Committee in the 117th Congress).
- ***Caroline Crenshaw*—**Johnson also interviewed Crenshaw, the SEC's newest commissioner. Johnson asked about executive compensation. Crenshaw spoke generally of striving for clarity so that everyone understands the SEC's expectations. Specifically, Crenshaw said investors need "visibility" tools to better understand compensation schemes. Crenshaw also suggested bonuses should be clawed back if there was erroneous reporting or if the bonuses were not earned in the context of the company's long-term performance measures. Crenshaw would discourage risk taking in which short-term goals are achieved at the expense of long-term interests. Crenshaw also suggested the SEC could address as yet unfinished Dodd-Frank Act executive compensation rulemakings.

Former SEC chairs. The former SEC chair panel included three chairs whose terms spanned the post-dotcom bubble period to the Great Recession to the post-Great Recession recovery prior to the COVID-19 pandemic. The former SEC chairs were: (1) Harvey Pitt (Republican, 2001-2003), CEO of Kalorama Partners LLC; (2) Mary Schapiro (Independent, 2009-2012), Vice Chair for Global Public Policy, Bloomberg L.P. and Senior Adviser to the Founder as well as Head of the Secretariat of the Task Force on Climate-related Financial Disclosures (TCFD); and (3) Mary Jo White (Independent, 2013-2017), Debevoise & Plimpton LLP.

- ***ESG and climate change*—**Schapiro noted that the SEC has been on the side lines for four years while the rest of the world had engaged on the subject. Schapiro also said the SEC could start by updating its 2010 guidance on climate change disclosure or it could comment on issuers' filings or engage in rulemaking. Schapiro also said the CFTC's climate report could serve as a road map to agencies' existing authorities. White agreed that climate change is an SEC priority but cautioned that there are differences of opinion on the current commission about how best to achieve disclosure. White also noted that the SEC may need to integrate SEC rules with private standards. White further noted that Treasury Secretary Janet Yellen will chair the Financial stability Oversight Council (FSOC), which could push federal financial regulators to deal with climate change. Pitt said the private sector is ahead of the public

sector on climate change. Both Schapiro and Pitt said Blackrock and other institutional funds are key players calling on firms to use either the SASB or TCFD standard. Whatever the SEC ultimately does to address climate change, all three former chairs said consistency and comparability will be key to the success of any climate change disclosure regime.

- ***Proxy reforms—***The Clayton-era SEC did a lot regarding proxy reforms by adopting comprehensive regulations for proxy advisers and increasing the shareholder proposal eligibility requirements and the related resubmission thresholds. White suggested that proxy access was a nonstarter because private ordering had taken care of that issue. But White suggested that shareholder proposals might be one area for further SEC action, although action on proxy advisers was unlikely pending the outcome of a lawsuit challenging the SEC's proxy adviser regulation. Pitt said it is important how companies respond to shareholder proposals; he said a company might not always be legally required to act on a proposal but it likely has a legal obligation to consider an issue and formulate a rational position.
- ***Regulation Best Interest—***All three former chairs seemed to be agreement that major changes to Regulation BI are unlikely, at least in the near term. Pitt suggested that a good first step could be to expand Regulation BI. For example, Pitt said the SEC might consider some aspects of the Department of Labor's original fiduciary rule as a source of additions to Regulation BI. White said a key blocker to major changes or repeal is the degree of difficulty involved in bring about a significant rollback; she agreed with Pitt that it would be easier to borrow from the DOL than to upend the entirety of the regulatory regime for broker-dealers and investment advisers. Schapiro suggested that the SEC could work with DOL on many topics, including Regulation BI, ESG funds, and target date funds. Schapiro even suggested the creation of a joint steering committee or task force or working group between the SEC and the DOL. White, however, observed that while the SEC often provides technical assistance to other agencies, a differing SEC view is not always well received. Both Pitt and White said the SEC might want to get some enforcement experience with Regulation BI before trying to make any changes to the regulation.
- ***Digital assets—***The SEC's foray into digital assets continues, although the Commission has focused its efforts on application of the Supreme Court's Howey test for investment contracts, despite issuing a "framework" that implies some degree of regulatory flexibility. White opined that perhaps a separate agency to regulate digital assets would be better than the current patchwork of agency oversight. White also said the SEC will need to increase its expertise in this area so it can understand what it is or is not regulating. White also noted the international dimension to digital assets. Pitt likened the digital asset era to Ray Garrett's tenure when the SEC lacked expertise on commodity futures. Pitt said the Biden Administration would need to give the SEC resources to increase its expertise. Pitt further suggested that the U.S. needs a government position on digital assets, not just an SEC or CFTC position.
- ***Capital formation—***Moderator Richard H. Walker of King & Spalding LLP prefaced this topic by noting that the Clayton-era SEC had streamlined the public offering process and had opened up private offerings to more investors, although private offerings still account for about 75 percent of all transactions. White emphasized that ideology should not play a role in SEC rules here because between public and private markets, one is not inherently better than the other. Pitt said it is critical for the SEC to understand why capital flows in a particular direction. According to Pitt the burden on public companies is part of the answer but alone would not be sufficient for the SEC to forbear. The consequence of opening private markets to more investors, Pitt said, is to expose a new group of investors to the risks of private offerings.
- ***Enforcement in general—***White began by observing that enforcement traditionally is a bipartisan effort at the SEC. White suggested that the Biden SEC could more frequently seek corporate penalties and higher penalty amounts while also taking a different approach to bad actor waivers, but she said many changes would be at the margins. Schapiro recommended that the SEC not neglect any areas within its purview because that can lead to new problems; White replied that she wanted people to think the SEC was everywhere, even if that was an impossible goal. Pitt suggested that the SEC could look at conduct that is reasonably contemplated by its rules, implying a potential widening of the agency's enforcement mandate. But Pitt saved perhaps his strongest critique of the SEC for his closing remarks

on enforcement: Pitt said it is "inappropriate" for commissioners to dissent in enforcement actions, as compared to a rulemaking where each commissioner is expected to take a policy position. In the enforcement context, Pitt said it would be better to simply state what the Commission's vote was on a particular matter.

- ***Disgorgement*—**Late in 2020, as part of non-securities legislation, Congress slipped in a provision providing for a 5 year limitations period on disgorgement in non-scienter-based securities matters, and a 10-year limitations period for scienter-based matters. Pitt reiterated his real time theory of enforcement in which the SEC should bring actions as quickly as possible to prevent defendants from hiding their illicit gains. Pitt said fast notice of an enforcement action to the public helps harmed investors the most. White, however, questioned whether the SEC may now be faced with an incentive to bring scienter-based actions when the agency otherwise would have brought or would have settled for non-scienter-based charges. White also paid homage to Pitt's real time theory of enforcement by suggesting that every chair since Pitt had aspired to such an approach.

Ex-CorpFin directors. To provide even more perspective on where the SEC may go in its future rulemakings, the institute included a panel of former CorpFin directors: John W. White (2006-2008), Cravath, Swaine & Moore LLP; (2) Meredith B. Cross (2009-2013), Wilmer Cutler Pickering Hale and Dorr LLP; (3) Keith F. Higgins (2013-2017), Ropes & Gray LLP. Much of the discussion centered on what to expect from the Biden Administration and whether and how the SEC may address various ESG topics, including climate change. This review of the ex-CorpFin director panel concludes with the topic the panel opened with—the significant leadership vacuum that will soon envelop CorpFin when its long-time deputy director, currently its acting director, Shelley Parratt, retires from the SEC.

Shortly after the Securities Regulation Institute ended, Acting Chair Lee appointed John Coates, the John F. Cogan Professor of Law and Economics at Harvard University, to serve as CorpFin's acting director.

- ***The Biden Administration*—**Although none of the former CorpFin directors suggested a specific SEC policy agenda, they all agreed that routine business is a large part of CorpFin's work no matter what larger policies a new administration may pursue. Cross related her experience during the Obama Administration's push for legislation. Cross noted that during the Dodd-Frank Act era the SEC created a team to determine if the SEC staff should take views on legislation or should persuade the chair to take views on legislation. Cross also said that much of the job of a CorpFin director is to avoid public surprises about troubled company filings. Higgins observed that a journalist (he did not say who) had suggested that the 117th Congress may emphasize company oversight instead of or in addition to government oversight. Higgins said he hoped the SEC's relationship with lawmakers will improve now that Democrats control both chambers of Congress, but he also noted that many of the SEC's Dodd-Frank Act rulemakings were complete and there was little remaining overhang of congressional mandates for lawmakers from both parties to urge the SEC to address. According to White, however, SEC leadership may think they know what agenda they want to pursue, but external factors can upset such plans. (e.g., On the last day of the conference, market volatility centered on social medial-fueled trading of GameStop stock generated headlines, to be followed days later by similar volatility in silver markets). White, like Cross, noted that routine work is the most pressing item for CorpFin, which he said devotes up to 80 percent of its time to the disclosure review process and other basic, everyday work. President Biden also recently signed an executive order imposing a regulatory freeze pending review. White and Cross agreed that typically such orders would not apply to an independent agency like the SEC, but even if the SEC elected to follow the order, it would be difficult for the Commission to take action because of its being evenly split between Democrat and Republican commissioners, pending the confirmation of a new SEC chair. Cross noted that the Biden Administration could still invoke the Congressional Review Act for late Trump-era regulations.
- ***MD&A amendments*—**With respect to the prospect of a regulatory freeze, moderator Kim asked what companies should do regarding the soon-to-be-effective MD&A amendments and, in particular, whether companies should early adopt. In November 2020, the SEC adopted changes to the Regulation S-

K requirements for, among other things, selected financial data (Item 301) and the Management's Discussion and Analysis or MD&A (Item 303). The changes are effective on February 10, 2021 with a mandatory compliance date of the first fiscal year ending on or after August 9, 2021. Early compliance is permitted after the effective date, provided such disclosure responds to an amended Item in its entirety. Cross noted that if the Commission wanted to alter the effective date, for example, they would have to come up with three votes to make that happen with a Commission that lacks a permanent chair and is otherwise evenly divided between Democrat and Republican commissioners. But Cross suggested that companies could early adopt "with their eyes wide open" because such decision would have low risk. Kim also asked if the former CorpFin directors were aware that at least one major audit firm was recommending against early adoption. White said he was aware of this development and that is was a bit surprising that any firm would recommend against early adoption.

- ***Human capital disclosures*—**Both Cross and White agreed that targeted, concentrated reviews of company filings could be an effective way to evaluate first-year compliance with the SEC's new human capital disclosure requirement. Cross added that such a review may show that principles-based disclosure is insufficient. Also, recall that now-Acting Commissioner Lee and Commissioner Peirce had engaged in a lengthy rulemaking colloquy over the adoption of other modernized Regulation S-K disclosures in which Lee would have relied less on principles-based disclosure and Peirce would have given primacy to principles-based disclosures.
- ***Climate change*—**White said the next big focus for the SEC will be climate change; he suggested that the SEC could conduct a study based on the 2010 guidance and compare disclosures about sustainability reports and companies' related disclosures regarding risk factors, their business descriptions, MD&A, and legal proceedings to see if the sustainability disclosures are mentioned throughout relevant portions of companies' filings. Moderator Kim noted the 2021 letter to CEOs issued by Blackrock's Larry Fink reiterating Blackrock's commitment to portfolio company data and disclosure. Fink, for example, said of climate change: "I believe that the pandemic has presented such an existential crisis – such a stark reminder of our fragility – that it has driven us to confront the global threat of climate change more forcefully and to consider how, like the pandemic, it will alter our lives." Fink also called on companies to disclose how the goal of net zero greenhouse gas emissions by 2050 is incorporated into their long-term strategy and how their boards review such strategy. Higgins suggested that the SEC should focus on Climate change disclosure because there are available general standards; he said trying to address ESG in its entirety could produce an unwieldy rulemaking akin to the defunct late 1990s "aircraft carrier" proposal. White said a first step towards a climate proposal could include a mix of principles-based catch-all provisions and some more specific metrics. According to Cross, SEC staff should map the choices for the new chair. Cross also noted that there is a groundswell of desire to move quickly with "something pretty consequential" but perhaps also with a few quick regulatory hits to demonstrate progress. Both White and Cross agreed that the "wildcard" (White's word) was the risk that Congress would move faster than the SEC and simply mandate line item ESG disclosures or mandate the adoption of one of the existing privately-created ESG sustainability standards. A congressional mandate, White added, could end up being automatically effective such that any related SEC rulemaking would be secondary to the mandate, as he said was the case with the SEC's say-on-pay regulation. Cross said a Commission vote on a climate risk proposal was unlikely to be unanimous because it is a "tough topic." She said that, as with the conflict minerals regulation, the SEC will have to document its cost-benefit analysis and work out how best to achieve assurances around certain likely disclosures. Moreover, White said that the PCAOB was still on the "edges" of ESG but if companies include ESG (e.g. climate disclosures) as "other information" along with audited financials, then auditors should be reading those additional disclosures. From White's perspective, companies can take two steps right now to improve their ESG disclosures: (1) the likelihood of companies receiving targeted comments from the SEC is high enough that companies should try now to make their ESG disclosures more robust in order to respond to the SEC in a thoughtful and reasoned manner; and (2) with respect to assurance, audit committees should mull companies' controllership function regarding the reliability of ESG data.

- ***Diversity and inclusion***—Higgins began the discussion of diversity and inclusion by suggesting that the SEC could pursue regulations akin to legislation taken up by the House in November 2019. By way of background, Improving Corporate Governance Through Diversity Act of 2019 (H.R. 5084), sponsored by Gregory Meeks (D-NY), would mandate issuer disclosures about their boardroom and C-suite diversity and inclusion efforts. Moreover, the proposed law would mandate that the SEC create a Diversity Advisory Group to study how to increase gender, racial, and ethnic representation on company boards. The bill passed the House by a vote of 281-135 in November 2019. "Studies have shown that the lack of diversity in C-suites and corporate boards is not only an injustice, it is a detriment to business and a hindrance to innovation," Rep. Meeks said in a press release. The U.S. chamber of Congress had at the time praised the bill for its deemphasis of quotas. Higgins added that regulations could be done rather quickly if the SEC chose to take that route. Cross, however, cautioned that the SEC might want to consider a wider approach to diversity and inclusion because it may not be enough to address only the upper echelon of companies. Cross also suggested that the SEC could expand its human capital disclosures to add some of the items Commissioners Lee and Crenshaw wanted to be included in the SEC's recent revisions to portions of Regulation S-K. Lee and Crenshaw had dissented because they objected to the omission of any specific references to diversity and climate risk from the final version of the Regulation S-K amendments.
- ***Shelley Parratt retirement***—Shelley Parratt, the current Acting CorpFin Director, has announced she will retire from the agency after 35 years. During her tenure, she was CorpFin's deputy director for 18 of those years and served as the Division's acting director on three occasions. For many years Parratt was the leader of the SEC's disclosure review program. In 2005, then-CorpFin Director Alan Beller announced that the SEC would make public on EDGAR the correspondence between SEC staff and companies regarding companies' disclosures made in registration statements and periodic filings. The publication of staff comments provided the impetus for related Wolters Kluwer products collecting the hundreds of thousands of published SEC Staff Comment Letters, which appear in both the Cheetah and RBSource Filings research platforms. Parratt also was a frequent panelist at many securities regulation conferences where she often presented a Top 10 list of topics SEC staff were asking companies about in staff comment letter dialogs. Higgins began by stating that it will be more difficult for the next director without Parratt but that CorpFin has a deep bench. White said Parratt was a key player in the SEC's role during the Great Recession in helping good financial institutions acquire bad ones, including establishing a framework for continuous reviews of large financial institutions. According to Cross, Parratt "had your back" and she could help with staffing and delegation of tasks that helped to free up the director's time.

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Companies: Kalorama Partners LLC

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