SEC 2021 and beyond: What to expect

Securities Enforcement Alert

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The election of Vice President Joe Biden and Senator Kamala Harris will bring substantive change to the SEC and how the Commission regulates public companies and other market participants in a variety of key areas. This alert addresses a number of the expected top priorities of a new Administration and a new Democratically controlled SEC.

To start, the leadership of the SEC will change. It will be interesting to see whom President-Elect Biden nominates to be chair of the SEC, but control of the Senate will have a significant impact on that selection. If the Republicans maintain control of the Senate by winning at least one of the Georgia runoff elections on January 5, 2021, that may temper the ability of the new Administration to push through the Senate a nominee with more progressive credentials – the result could be a nominee who is more mainstream. Notably, the party in control of the Senate also controls the timing of nominee considerations – a Republican-controlled Senate could choose to take its time in confirming a new SEC chair. Furthermore, the Senate Committee on Banking, Housing and Urban Affairs, which would hold the hearings on a new SEC chair nominee, is expected to have a new chairperson as well.

While there may be delay in appointing a new SEC chair, eventually that change will occur. No one has a crystal ball, but here are some of the likely areas of SEC focus from both the regulatory and enforcement perspectives in 2021 and beyond:

REGULATORY

We expect the SEC to expand disclosure requirements related to an array of social issues. This should not come as a surprise, since the Democratic Commissioners have dissented in many recent SEC rulemakings. Likely priorities include:

ESG: We expect the SEC to focus quickly on environmental disclosures related to carbon footprint and greenhouse gas emissions both from the standpoint of disclosing the environmental impact of the business as well as risks the business faces related to environmental issues. There have been many requests for the SEC to develop a standardized comprehensive framework under which public companies would be required to disclose identified environmental, social, and governance (ESG) factors relating to their operations, including most recently from the ESG Subcommittee of SEC's Asset Management Advisory Committee.[1] The SEC has resisted such requests,[2] even though Commissioners Caroline A. Crenshaw and Allison Herren Lee have dissented on some recent SEC rulemaking and laid out reasons why the SEC should act to require additional ESG disclosure.[3]

The SEC's expected shift on ESG disclosures, particularly with respect to climate impacts, fits neatly into President-Elect Biden's broader focus on addressing climate change across federal agencies. Janet Yellen, who has been tapped to become the next Secretary of the Treasury, has long advocated a tax on carbon as a way to mitigate emissions that contribute to climate change. And many expect a role in Biden's EPA for Mary Nichols, the outgoing chair of the California Air Resources Board, which oversees the country's largest carbon market, second only to the EU globally. But perhaps most telling is the designation of John Kerry as the administration's "climate czar." As President Barack Obama's Secretary of State, Kerry was a central figure in the high-level negotiations around the 2015 Paris Climate Agreement. President-Elect Joe Biden has promised to rejoin the Paris Agreement on his first day in office

Amendments related to additional ESG disclosure are expected to be a top priority for the SEC. Expect new or amended rules over time, but in the near term, the SEC staff can issue guidance and can also update Industry Guides on this topic. Companies should consider some of the standards published by the Sustainability Accounting Standards Board for possible standards the SEC may consider.

Human capital/work force diversity and inclusion*:* The SEC's August 2020 amendments to Regulation S-K did address this topic, as discussed here. Commissioners Crenshaw and Lee in their dissents again faulted the SEC majority for not doing enough. This is another area where we believe the SEC will act promptly to require more robust disclosure related to workforce composition, including on topics such as pay equity, gender, race and ethnicity. It is also likely that the SEC will require similar disclosure requirements related the composition of a company's board of directors and Nasdaq has already proposed revised listing rules that would require such disclosures and also require more diverse boards.[4]

Main Street investors/private markets*:* The SEC is likely to revisit some of the actions taken by the prior SEC, including past actions that allow more Main Street investor funds to participate in private equity. For example, it is possible that the SEC may revisit the dollar thresholds for accredited investors as well as the recently amended size limits for private placements.

Proxies: The SEC will likely take steps to make it easier for shareholders to nominate board candidates and to face fewer hurdles in making proposals. Commissioners Crenshaw and Lee dissented from the SEC's recent amendments to the procedures governing shareholder proposals. Those proposals increased the ownership and time thresholds necessary for shareholders to have their proposals included in proxy materials. The reconstituted SEC may favor more shareholder engagement and greater access for small shareholders, may act to revise the new thresholds and make it easier for shareholders to make proposals.

Regulation Best Interest*:* When Regulation BI became effective, there was criticism that the regulation's requirement that broker-dealers make only recommendations that were in the best interests of their customers was insufficient to protect investors. While we expect the rule to remain in place, a reconstituted SEC may act to tighten the rule further, for example to further restrict sales incentives.

ENFORCEMENT

The SEC's Division of Enforcement will be more active and more aggressive in the years ahead. It is likely that the agency will work hard to increase its enforcement budget and expand hiring of subject matter experts. It is also possible that the new Biden-Harris Administration could seek to increase the proposed budget for enforcement activities at the SEC; however, it is unclear if a Republican controlled Senate (if that is the outcome that results from the Georgia runoff elections in January), would agree to and approve an increase in appropriations funding for such enhanced enforcement.

Regardless, the SEC can reallocate funding internally to make enforcement a greater priority. While Main Street investors will remain a key focus, enforcement activity is likely to expand in at least the following areas:

Public companies*:* Recent statistics presented by Cornerstone Research and New York University's Pollack Center for Law & Business reflect that in 2020, SEC actions against public companies hit a six-year low. We anticipate that the SEC will try to reverse that trend beginning in 2021. Higher penalties on public companies may also result from a shift in the make-up of the SEC. Expect close scrutiny of financial statements and disclosures related to the impact of COVID-19, asset impairment analysis and risk factors, to name a few areas. In addition, be prepared for cases developed through the SEC's use of data analytics to identify corporate outliers in various sectors and across various metrics.

Broker-dealers, investment advisers and their associated persons*:* Expect increased enforcement investigations and actions involving large Wall Street firms. Some have repeatedly criticized the SEC for failures to act against such firms, and the SEC is likely to respond to those criticisms.

In addition, the Office of Compliance, Inspections and Examinations (OCIE) has issued a number of risk alerts and reports on topics including cybersecurity, compliance program deficiencies, supervisory issues, compliance with Reg BI and Form CRS, and deficiencies at private fund advisers related to a number of topics.

While OCIE has worked with market participants to address these issues, particularly during the coronavirus disease 2019 (COVID-19) pandemic, in 2021 and beyond it is likely that more of these matters will be referred to the Enforcement Division resulting in increased enforcement activity. The SEC has brought many cases in areas related to fees and expenses and conflicts of interest but in addition to more cases on those topics, we expect cases related to all of the topics identified in OCIE's risk alerts. In particular, expect stepped-up enforcement of Regulation BI's requirement that brokers act in the best interest of their clients. As with public companies, regulated entities and their associated persons should expect higher penalties as the result of any violations.

Funds: Both public and private funds should anticipate greater enforcement scrutiny related to the topics identified by OCIE including disclosures related to fees and expenses, conflicts of interest and allocation practices. Enforcement will likely also focus on whether funds are investing consistently with their disclosed investment strategy, particularly in light of the challenges of COVID-19. Finally, expect increased enforcement surrounding valuation disclosures, controls and practices, particularly related to assets likely impacted by the pandemic.

Insider trading/market manipulation: We expect to see increased enforcement focus in these areas as part of an increasingly aggressive message of no tolerance for securities law violations. While the SEC focused on COVID-19 related insider trading issues throughout 2020, we anticipate that focus will broaden in 2021. The SEC will continue to expand its use of data analytics to evaluate trading patterns in its search for suspicious activity. In addition, the SEC may begin to explore information disparities more broadly as part of increased insider trading enforcement.

FCPA: FCPA cases were reportedly way down in 2020. That will change starting in 2021 as the SEC increases its focus on, among other things, areas such as international corporate supply chains and how those supply chains were operated during COVID-19. Expect a return to traditional levels of FCPA enforcement.

Broken Windows 2.0: The SEC may return to greater enforcement of regulatory violations uncovered as the result of sweeps related to compliance with a broad array of regulations. The extent to which the Enforcement Division reinvigorates the program will be impacted by funding and resources, however. Whether to return to these types of enforcement initiatives is already a topic of debate.

Bad actor waivers: As the new SEC takes shape, companies and individuals whom the agency views as bad actors might find that obtaining a waiver will become more difficult. The SEC may seek to impose conditions on any waiver or deny it outright. Critics have been outspoken about the perceived ease with which those who have violated the securities laws more than once are able to obtain waivers, and the new SEC may act to tighten the waiver process.

In sum, we expect the SEC to be extremely active in the next several years on all fronts as the agency seeks to advance certain goals such as increased corporate responsibility related to ESG, governance and other social issues, and to make certain that enforcement focuses on public companies and large Wall Street firms while continuing to protect Main Street investors.

If you have any questions, please contact any of the authors or your DLA Piper relationship partner.

[1] See, eg, “Potential recommendations of the ESG subcommittee” and this Petition for Rulemaking.

[2] See Commissioner Peirce’s Opening Remarks at the December 1, 2020 Meeting of the Asset Management Advisory Committee, and Chair Clayton’s Remarks at Meeting of the Asset Management Advisory Committee .

[3] See Statement on the “Modernization” of Regulation S-K Items 101, 103 and 105 , Regulation S-K and ESG Disclosures: An Unsustainable Silence and Joint Statement on Amendments to Regulation S-K: Management’s Discussion and Analysis, Selected Financial Data, and Supplementary Information.

[4] See Nasdaq press release dated December 1, 2020, available here.

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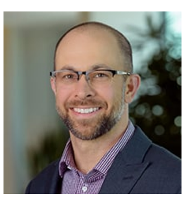

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