2017 SEC Speaks: Changing Priorities Amid Leadership Transitions

02.28.2017 | UPDATES

At the annual "SEC Speaks" conference held February 23-24, 2017, in Washington, D.C., the U.S. Securities and Exchange Commission's senior leadership reviewed the agency's efforts in 2016 and previewed future trends. These remarks were highly anticipated, as the agency grapples with a new administration that has already signaled meaningful changes in agency rules and enforcement priorities.

With Commission vacancies leaving three empty seats, the two remaining Commissioners—Acting Chairman Michael Piwowar and Commissioner Kara Stein—both shared their thoughts on achieving one of the agency's core mandates: investor protection. Acting Chairman Piwowar spoke in favor of removing what he sees as major impediments to investor protection, including "special interest" disclosure provisions and the accredited investor threshold. Commissioner Stein also addressed investor safety, and cautioned that as we enter an era that may bring the relaxing of rules governing how companies raise capital, the Commission should be mindful of potential harm to investors. She also emphasized the need to ensure adequate disclosures in highly complex retail products.

Thus, while the goal of investor protection remains paramount, the path to achieving that goal remains in flux. Senior officials from the various SEC divisions also spoke, but their views on priorities and plans remain uncertain given the change in administration and recent efforts by the Acting Chair to reexamine certain Dodd-Frank disclosure rules and restrain the powers delegated to the SEC's Enforcement Division. More clarity is expected in the coming year as a new SEC Chairman and Commissioners are appointed, additional staff leadership changes take place in various divisions, and potential amendments to Dodd-Frank and related rules become effective.

Below are noteworthy priorities and additional initiatives highlighted by senior SEC leadership during this year's conference.

SEC's Acting Chair Spotlights the "Forgotten Investor"

During his opening remarks, Acting Chairman Michael Piwowar challenged his audience to focus on an often over looked constituency, the "Forgotten Investor." Piwowar took aim at three key concerns: special interest disclosure provisions, the "accredited investor" threshold, and increased civil monetary penalties against corporations.

Piwowar commented that the SEC's current disclosure regime has been repeatedly "co-opted" for political purposes, resulting in an "avalanche of immaterial information" that inundates ordinary investors. In particular, Piwowar noted that Dodd-Frank's conflict minerals, pay ratio and resource extraction provisions ultimately burden the "Forgotten Investor," requiring companies to expend shareholder and company resources to provide non-material disclosures. In fact, Piwowar has asked the SEC staff to reconsider the implementation of the conflict minerals and pay ratio requirements, and noted that Congress and President Trump have already vacated the resource extraction disclosure rules.

Piwowar also questioned Regulation D's strictures for private offerings, which draw what he called an "artificial distinction" between accredited investors and non-accredited investors, a divide he likened to that between the "Davos jet set" and "les Misérables." Only accredited investors that meet certain wealth thresholds are permitted to invest in unregistered securities, including the high-risk ventures that often yield the highest returns. According to Piwowar, the exclusion of non-accredited investors limits the ability of ordinary investors to diversify their portfolios and invest in these high-risk, high-return securities.

Finally, Piwowar cautioned that while it is "entirely appropriate to discipline and punish corporate malefactors" who violate the securities laws, the SEC must also consider the unintended impact on investors when corporate civil monetary penalties are imposed. His concerns represent a continuation of the hotly debated issue that led the SEC to adopt a penalty framework requiring the assessment of shareholder harm during the last Republican-controlled Commission. Piwowar acknowledged, however, that civil penalties may still be appropriate in certain cases. Regulated entities such as broker-dealers and investment advisers operate in a more highly regulated environment and are required to disclose in their corporate filings that they may be subject to penalties if they violate the securities laws, putting shareholders on fair notice. Similarly, Piwowar noted that civil penalties may also be appropriate in Foreign Corrupt Practices Act (FCPA) cases. Citing studies finding that when FCPA-related violations are revealed to the market, stock prices do not always

fall and actually may increase, Piwowar reasoned there may be less of an impact on the "Forgotten Investor" in such cases.

Notably, Piwowar did not comment on his recent efforts to curb the Enforcement Division's authority and independence. According to published reports, Piwowar recently stripped several senior enforcement officials of the delegated authority to open formal investigations without first seeking Commission approval. While the Director of the Enforcement Division currently retains the power to do so, it may not be long before the Director too is relieved of this authority. Whether delegated authority is ultimately removed partially or altogether, this shift will certainly give Commissioners increased control over the enforcement agenda and may slow the pace of enforcement overall.

Despite Shifting Environment, Enforcement Division Signals Continued Rigor

Given the Commission's current state of flux, senior enforcement officials focused on the SEC's many successes in 2016 and at times, spoke self-assuredly about their continuing efforts to pursue enforcement initiatives and long-held priorities.

For example, the pace of FCPA enforcement remained high in 2016, with the largest number of enforcement actions and monetary sanctions to date. Deputy Chief of the FCPA Unit, Charles E. Cain, added that the SEC has also been "sourcing its own cases" by looking at competitors of FCPA violators who use the same third-party intermediaries, and will continue to focus enforcement efforts on the financial services sector in the coming year. Cain further stated that the agency will continue to coordinate enforcement efforts with its international counterparts, having received information from two dozen countries in the past year alone.

Cain also stressed the benefits of cooperation, particularly through making an early self-disclosure, reporting internal investigation results in real-time, facilitating witness interviews, producing materials from overseas, and sharing witness interview summaries. His comments echoed those of other Enforcement Division panelists who stressed that the SEC could decline cases, settle charges with non-scienter-based violations, reduce penalties (or in some cases, eliminate penalties entirely), and offer bifurcated settlements to those who provide early and full cooperation.

However, the Enforcement Division may have to contend with a Commission more skeptical of the FCPA as an enforcement priority. In 2011, a committee chaired by Jay Clayton, the presumed new SEC Chairman, expressed critical views of the FCPA and contended that it harmed U.S. businesses. Whether Clayton still holds such views—and whether they are shared by a majority of the yet-to-be-announced Commissioners—remains unknown. If, however, a majority of the Commission reflects the President's own critical view of the FCPA, there may be an impact on the scope and pace of anti-corruption enforcement.

SEC to Focus on Cyber-Security in 2017

David Gottesman, Acting Co-Chief Litigation Counsel, addressed the SEC's efforts to investigate and combat cyber-fraud. Gottesman observed that the SEC has seen an increase in hacking schemes involving the theft of sensitive non-public information, as well as efforts to manipulate stock prices through the dissemination of "fake news." When asked whether the SEC would consider bringing an action against an entity who had been hacked (in addition to the hackers themselves), Gottesman indicated the SEC generally continues to view hacked entities as victims. However, he would not rule out the possibility that the SEC would hold a hacked issuer liable, particularly if it failed to implement robust cyber-security policies or procedures to mitigate risks, or knew it had vulnerabilities and failed to address them. In the same vein, acting SEC Enforcement Division Director Stephanie Avakian said she could foresee bringing a data breach disclosure case against a public company. Any such action would have to overcome the materiality hurdle, however, especially because the internal controls theory against issuers in data breach cases remains untested.

"Investor-First" Focus Appears in Additional SEC Priorities

The Office of Compliance Inspections and Examinations (OCIE) highlighted the needs of individual investors in its Examination Priorities for 2017. OCIE staff noted that its examination initiatives would focus on issues affecting retail investors, such as "robo-adviser" practices, wrap fee programs and newly registered investment advisers, as well as services directed at elderly and retiring investors. OCIE added that its approach will likely depend on the fate of the U.S. Department of Labor's fiduciary rule, which has garnered scrutiny by the Trump administration.

The SEC's Division of Trading and Markets discussed proposed rules for liquidity management in the broker-dealer space, which would impose increased liquidity requirements and require monthly liquidity stress tests. Additionally, the Division noted efforts by a number of exchanges to implement controls seeking to level the playing field between retail investors and high-frequency traders by introducing intentional access delays, in accordance with recent SEC guidance.

Finally, the Office of the Chief Accountant pledged to maintain its focus on revenue recognition, stating that exam auditors should remain on guard against “complex” financial statements that actually mask fraud. The coming year will bring significant changes in revenue recognition accounting as new Accounting Standards Updates become effective.

Legal Developments Continue to Shape Enforcement

The Office of General Counsel addressed developments regarding insider-trading tipping liability, as clarified by the U.S. Supreme Court in *Salman v. United States*. The Court, in resolving a split created by the U.S. Court of Appeals for the Second Circuit’s ruling in *United States v. Newman*, held that a tippee can be liable when an insider “gifts” confidential information to trading relatives. The SEC noted it has increasingly brought cases against a broader class of tippees and tipping chains, and the remote level of tippee liability remains unresolved by the Supreme Court’s narrow holding in *Salman*.

With respect to the SEC’s administrative proceedings process, the staff acknowledged a circuit split created by the U.S. Court of Appeals for the Tenth Circuit’s holding in *Bandimere v. SEC* that the process the SEC currently uses to select administrative law judges was unconstitutional, and that further developments were expected in the coming year. Panelists commented that this unsettled status would be a factor in determining whether and where to pursue administrative proceedings.

Finally, the staff addressed concerns regarding the future of the whistleblower program. Panelists discussed whether whistleblowers who bring complaints internally but not to the SEC are protected from employer retaliation. The panel acknowledged this debate coincides with the Trump administration’s comments about dismantling some of Dodd-Frank’s protections, although it is not clear whether whistleblower laws will be targeted. Relatedly, Jane Norberg, Chief of the SEC’s Whistleblower Office, highlighted the SEC’s aggressive posture in enforcing the whistleblower rules, particularly with respect to employment agreements. In a noteworthy statement, Norberg said companies reviewing such agreements for compliance with the whistleblower rules should do so through the eyes of the employee. However, under the law, employers have no obligation to craft such agreements with language *favoring* employees.

Resolution of Leadership Vacuum Will Bring Clarity

Simply put, the tensions between “old” and “new” were pronounced at this year’s SEC Speaks. Acting Chairman Piwowar’s opening remarks and recent actions may signal a less aggressive posture in SEC rulemaking, policies and enforcement. Yet, Piwowar’s comments also signaled that Commissioners—present and future—may find common ground in certain areas, such as individual accountability, FCPA enforcement (penalties) and the need to streamline and clarify disclosure requirements meant to protect investors. More clarity will come as the new Chairman and Commissioners begin their tenure, and the makeup of senior staff leadership settles. We also expect to see a very different SEC Speaks in 2018, when this year’s talk turns into action and begins to bear transparent priorities and policies.

This update was also published in *Law360* on 02.27.2017, "SEC Speaks '17: Changing Priorities Amid Agency Transitions."

CONTACTS

Keith Miller
Regina (Gina) L. LaMonica
Luis R. Mejia
Pravin Rao
Amy Chang

Related Services

- Securities Litigation
- White Collar & Investigations Corporate
- Governance & Securities Corporate
- Finance
- Public Companies

© 2017 Perkins Coie LLP