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SEC top five:

what public companies, boards
and investors should watch for
in 2019

Introduction

The U.S. Securities and Exchange Commission (SEC) has a 2019 agenda that includes promoting capital formation, revamping the proxy process and monitoring company disclosures about cyber risks and incidents and the impact of Brexit, among other topics. SEC Chairman Jay Clayton has signaled his intention to follow through on priorities established in 2018 while also initiating several new ones discussed below.

This publication examines the elements of the 2019 SEC agenda with the greatest potential impact for issuers, boards and investors.

The SEC's timetable for accomplishing its agenda may be delayed because the agency was closed during the recent government shutdown that began on 27 December. The SEC resumed normal operations on 26 January and began addressing the backlog resulting from the

shutdown. For example, the staff of the Division of Corporation Finance (DCF) announced that it would process filings and requests for staff action in the order received unless compelling circumstances require expedited treatment.¹

As of 1 January, the Commission comprises four members, including Clayton. Following the departure of Commissioner Kara Stein, who took office in 2013 and whose term ended on 31 December 2018, all sitting commissioners are appointees of President Donald Trump. The White House has not indicated when it will nominate a candidate to fill Stein's seat, which is expected to go to a Democrat.² Despite the vacancy, the work of the Commission is expected to proceed as normal, with only three commissioners needed to form a quorum for the purposes of voting on Commission actions.³

1. See, for example, the statement from the SEC Division of Corporation Finance, 27 January 2019, <https://www.sec.gov/page/corpfm-section-landing>, accessed February 2019.

2. According to the Securities Exchange Act of 1934, the Commission may have no more than three members of the same party. As Clayton is an independent, the open seat could technically go to a Republican or another independent.

3. 17 CFR §200.41.



Here is a snapshot of some key 2018 SEC activities that will likely continue to serve as a basis for 2019 priorities:

- ▶ Capital formation remained a high priority for Clayton, who has continued to voice concern about the low number of IPOs over the past decade – especially for companies that are in the earlier stages of their growth trajectories – and the negative consequences for retail investors with limited access to private markets.
- ▶ The SEC took several steps to entice companies to raise capital in the US public capital markets, including amending the definition of a smaller reporting company to allow more companies to qualify for certain scaled disclosure requirements and eliminating redundant and outdated disclosure requirements.
- ▶ Clayton and SEC Chief Accountant Wesley Bricker communicated the importance of high-quality financial reporting and highlighted the responsibilities of audit committees, boards and management in achieving high-quality financial reporting in light of the rapidly changing technological landscape, accounting and audit standard changes and increasing cybercrime.

- ▶ The SEC also maintained an active enforcement agenda in 2018 with a particular focus on cases affecting retail investors and those related to emerging technologies and products, such as initial coin offerings (ICOs).

2019 SEC key priorities

1. Capital formation remains a central SEC priority

Clayton remains focused on increasing the attractiveness of US public markets and continues to explore ways to expand investment options for retail investors while maintaining adequate investor protection. He has acknowledged that no single policy initiative⁴ will reverse the decline in IPOs over the past two decades or expand investment options for retail investors; rather, he has suggested that the Commission will continue to take a multifaceted approach to facilitating capital formation in 2019.

The SEC issued a four-year strategic plan in October 2018 that will guide its actions in the coming years:

- ▶ **Goal 1** – Focus on the long-term interests of Main Street investors, including by better understanding how a wider range of investors can participate in the capital markets. Some initiatives related to this goal include modernizing public company disclosures and expanding retail investment options.
- ▶ **Goal 2** – Recognize significant developments and trends in the capital markets, with an eye on effective resource allocation. This includes developing and maintaining an understanding of the evolution of the “cyber landscape.”
- ▶ **Goal 3** – Improve the SEC’s performance through enhanced analytical capabilities and human capital development. This includes investment in data and technology.

4. “Remarks on Capital Formation at the Nashville 36|86 Entrepreneurship Festival,” Jay Clayton, 29 August 2018, <https://www.sec.gov/news/speech/speech-clayton-082918>, accessed February 2019.



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The issue of facilitating capital formation and increasing the attractiveness of the public markets for smaller companies is one of my highest priorities as SEC Chairman. I am concerned that Main Street investors are bearing costs (and missing investment opportunities) as a result of the shrinking number of US-listed public companies.

– Chairman Jay Clayton
“Remarks at the Equity Market Structure Symposium,”
10 April 2018

Expected action in 2019: proposed rule to reduce internal control attestation requirements for certain smaller companies

Clayton has stated that a one-size-fits-all approach to disclosure has not been effective for smaller companies, as the expense, burden and complexity of current regulations can pose a barrier to entry to the public markets. To address this, the SEC will consider whether to exclude more companies from the requirements of Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires certain public companies to obtain an auditor attestation of their internal control over financial reporting (ICFR).⁵ This effort builds on a 2018 rule that raised the threshold for the size of company that qualifies for other scaled disclosure requirements as a smaller reporting company.

Expected action in 2019: consideration of responses to proposed rule expanding “testing the waters” accommodations

In February 2019, the Commission issued a [rule proposal](#)⁶ to allow all companies that are eyeing initial public offerings to “test the waters” by communicating with certain potential institutional investors earlier in the process of registration statement filing. This rule change would allow companies to get feedback about the attractiveness of the offering, reducing some of the uncertainty of going public. Currently, only emerging growth companies are allowed to do this.

5. “Testimony on ‘Oversight of the U.S. Securities and Exchange Commission,’” Jay Clayton, Committee on Banking, Housing and Urban Affairs, United States Senate, 11 December 2018, <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0>, accessed February 2019.

6. “Solicitations of Interest Prior to a Registered Public Offering,” Securities and Exchange Commission, 19 February 2019, <https://www.sec.gov/rules/proposed/2019/33-10607.pdf>, accessed February 2019.



Expected action in 2019: consideration of possible changes to quarterly reporting and earnings releases to reduce regulatory requirements and promote long-term investing

In December, the Commission issued a [request for public comment](#) seeking input on ways to reduce the administrative burden of quarterly reports while maintaining or enhancing investor protections, such as by allowing companies to satisfy quarterly reporting requirements through voluntarily provided earnings releases. In addition, the SEC asked whether the frequency of interim reports should be modified for all or some companies, such as smaller companies. The SEC also posed questions about how the quarterly reporting process affects corporate decision-making. In particular, the SEC is interested in whether the practice of providing quarterly earnings guidance creates an undue focus on short-term results and, if so, what rule changes might address such concerns.

Expected action in 2019: concept release on potential changes to the private offering framework

The Commission expects to initiate a project to harmonize and streamline the private offering exemptive framework, which Clayton has stated is an important way for small businesses to raise capital but is “an elaborate patchwork” today. This will include soliciting input on changes to the accredited investor definition – a principal barrier to participation in private securities offerings – to consider whether retail investors should have greater access to these investment opportunities by focusing “more on the sophistication of the investor, the amount of the investment, or other criteria rather than just the wealth of the investor.”⁷

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The SEC is committed to efforts to develop a regulatory framework that equally serves the neighborhood coffee shop that is looking to expand into a second location, the biotech startup looking to hire more scientists to cure cancer, the social media company looking to conduct its IPO, and the Main Street investor saving for their future.

– Chairman Jay Clayton
“Remarks on Capital Formation at the Nashville 36|86 Entrepreneurship Festival,” 29 August 2018

7. “Testimony on ‘Oversight of the U.S. Securities and Exchange Commission,’” Jay Clayton, Committee on Banking, Housing and Urban Affairs, United States Senate, 11 December 2018, <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0>, accessed February 2019.



2. Disclosure is on the agenda

Expected action in 2019: proposed rules to streamline and modernize certain disclosure requirements

The SEC has placed several projects on its short-term agenda to streamline and modernize disclosure requirements. These include proposing amendments to Regulation S-X on the disclosure of financial information relating to acquired businesses and updates to Industry Guide 3 on bank holding company disclosures. Another project would modernize certain business and nonfinancial disclosure requirements found in Regulation S-K. This project would build on a concept release issued in 2016 covering a wide range of disclosure requirements.⁸ DCF Director Bill Hinman also has indicated that he hopes the SEC will adopt the July 2018 proposal that would help streamline and simplify financial disclosures relating to guaranteed and collateralized debt securities.⁹

Expected action in 2019: scrutiny of company disclosures on Brexit and cybersecurity issues

Brexit

Clayton has expressed concern that the market does not fully understand the implications of the United Kingdom's planned exit from the European Union and that disclosures to investors may be insufficient. He also has noted that many uncertainties surround Brexit, including whether

and when a deal will be struck between the EU and the UK and the terms on which the UK will leave the EU. Further, he has indicated that there is the potential for many companies' operations to be disrupted by a "hard" Brexit, and this possibility may be underestimated by both companies and investors. For example, a hard Brexit could mean that products must go through customs when traveling between the EU and the UK, adding significantly to the time and cost of trade between the two.

Cybersecurity

As cybersecurity has taken on greater prominence, Clayton and SEC staff continue to communicate concerns that public companies are not adequately disclosing their cybersecurity risks to investors. The DCF also will be closely reviewing cybersecurity-related disclosures to ensure that companies are following the interpretive guidance issued by the Commission in February 2018. That guidance emphasized the importance of disclosure controls and procedures so that information about cybersecurity incidents gets to management and those responsible for public disclosures in time to consider the public disclosure implications.

Clayton and DCF staff also have called out the need for board-level attention on cybersecurity and the related corporate governance disclosures, which must describe how the board oversees risk management, including cybersecurity risk. Company-specific disclosures also must be tailored to a company's circumstances rather than boilerplate.

8. "Business and Financial Disclosure Required by Regulation S-K," Securities and Exchange Commission, 13 April 2018, <https://www.sec.gov/rules/concept/2016/33-10064.pdf>, accessed February 2019.

9. "2018 AICPA Conference on Current SEC and PCAOB Developments," Ernst & Young LLP, December 2018, accessed January 2019.



Cybersecurity monitoring: To promote appropriate disclosures, the staff is monitoring cybersecurity incidents in the news and reviewing related company disclosures, reaching out to companies where necessary for additional information. DCF Director Bill Hinman has noted that disclosures in this area have been a “mixed bag.”¹⁰ (See the EY analysis of cybersecurity-related disclosures of Fortune 100 companies showing that the depth and nature of cybersecurity-related disclosures vary widely.)

Expected action in 2019: Dodd-Frank rulemaking

- ▶ Rule re-proposal on disclosure of payments to governments by resource extraction companies
- ▶ Implementation of rule requiring disclosure of hedging policies for employees, officers and directors

The SEC currently has several rulemakings on its short and long term agendas, which are required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). One with potential impact for issuers is a re-proposed rule to require resource extraction companies to disclose payments to governments. While the SEC adopted a final rule in 2016 to implement this provision of the Dodd-Frank Act, Congress overturned it in 2017.

With respect to other pending rules required by the Dodd-Frank Act that relate to executive compensation, Clayton has suggested that the Commission will implement them one by one because of the complexity and scope of the current executive compensation framework.¹¹ When prioritizing the order in which the rules will be implemented, Clayton said that the SEC will take into account whether market developments – such as companies voluntarily establishing mechanisms to claw back executive compensation following a material financial restatement – have already addressed the concerns underlying the Dodd-Frank provisions.

In December 2018, as required by the Act, the Commission issued a final rule to require companies to disclose their policies regarding whether employees, officers and directors are allowed to hedge direct or indirect holdings or grants of company securities.¹² Most large issuers must include this information in proxy materials for the election of directors in fiscal years that begin on or after 1 July 2019. Smaller reporting companies and emerging growth companies have an additional year to disclose this information.

10. “2018 AICPA Conference on Current SEC and PCAOB Developments,” Ernst & Young LLP, December 2018, accessed January 2019.

11. “Testimony on ‘Oversight of the U.S. Securities and Exchange Commission,’” Jay Clayton, Committee on Banking, Housing and Urban Affairs, United States Senate, 11 December 2018, <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0>, accessed February 2019. Dodd-Frank rules that the SEC still must finalize include requiring disclosure of executive pay compared with company performance and companies listed on stock exchanges to have clawback provisions for excess executive incentive compensation following a material financial restatement. Dodd-Frank Act Sections 953(a) and 954, respectively.

12. Dodd-Frank Act Section 955.



3. Emerging technology continues to be a top priority

Clayton has stated that the SEC is seeking to take a “balanced regulatory approach” to FinTech developments – looking to support innovative technologies that could promote capital formation while also protecting investors.¹³

Expected action in 2019: continued engagement with market participants on the interaction of the securities laws with FinTech

In keeping with the SEC’s strategic goal of innovating and being responsive to new developments and trends, the agency has signaled its intention to expand outreach to market participants regarding new technologies and their role in US capital markets, including through its [Strategic Hub](#) for Innovation and Financial Technology (FinHub). Established last October, FinHub helps connect investors and market participants to SEC personnel across the agency on FinTech-related issues, including distributed ledger technology (DLT), artificial intelligence and machine learning, automated investment advice and digital marketplace financing.

Expected action in 2019: continued monitoring of FinTech companies’ compliance with the securities laws and investigations by the Division of Enforcement where market participants fall short

The SEC continues to closely monitor ICOs and other FinTech-related market developments to assess whether US securities laws are being followed. During

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Given the explosion of ICOs over the last year, we have tried to pursue cases that deliver broad messages and have market impact beyond their own four corners. To that end, we have used various tools — some traditional, such as the Commission’s trading suspension authority, and some more novel, such as the issuance of public statements — to educate investors and market participants, including lawyers, accountants, and other gatekeepers.

– Division of Enforcement Co-Directors Stephanie Avakian and Steven Peiken

[Annual Report](#), Division of Enforcement

13. “Testimony on ‘Oversight of the U.S. Securities and Exchange Commission,’” Jay Clayton, Committee on Banking, Housing and Urban Affairs, United States Senate, 11 December 2018, <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0>, accessed February 2019.



a February 2018 Senate Banking Committee hearing on virtual currencies, Clayton stated: "I believe every ICO I've seen is a security [offering]."¹⁴ In September 2018 remarks, SEC Chief Accountant Bricker reminded issuers of the need to "continue to maintain appropriate books and records – regardless of whether distributed ledger technology (such as blockchain), smart contracts and other technology-driven applications are (or are not) used."¹⁵ The divisions of Trading and Markets, Corporation Finance and Investment Management issued [a statement](#) in November to highlight that all market participants dealing with ICOs and digital assets must comply with the securities laws – including broker-dealers, exchanges and investment funds.¹⁶

The Division of Enforcement has investigated numerous companies offering digital assets and ICOs as well as those touting plans to use blockchain or DLT to inflate their stock prices.¹⁷ Investigations involving hacking, account intrusions and failures to protect personal information are being prioritized. The division's annual 2018 report notes that "many" of its dozens of investigations involving ICOs and digital assets "were ongoing at the close of FY 2018," so additional settlements, administrative proceedings and court cases are likely to continue throughout 2019. The SEC also is coordinating with other regulators, such as the Commodity Futures Trading Commission (CFTC), to investigate digital asset securities issuance and trading.

4. Expect renewed focus on the proxy process

The SEC is expected to take action regarding various aspects of the proxy process in 2019.

Expected action in 2019: SEC staff development of recommendations regarding how to improve the proxy process

Following a roundtable in November 2018 to consider the proxy process and shareholder engagement in light of recent changes in markets, technology and company operations, Clayton has identified three areas in which the SEC staff is formulating recommendations for the Commission to consider:¹⁸

► **Proxy solicitation and voting process**

Clayton has suggested that "proxy plumbing" – the mechanisms through which companies and investors communicate with each other regarding matters on which shareholders vote by proxy – requires a major overhaul and that new technologies, including DLT, could be used to improve it. He has further noted that such an overhaul likely would take time, and the SEC may seek to take action in the short term to make incremental improvements.

14. Stan Higgins, "SEC Chief Clayton: 'Every ICO I've seen is a security,'" Coindesk, 6 February 2018, <https://www.coindesk.com/sec-chief-clayton-every-ico-ive-seen-security>, accessed February 2019.

15. "Remarks before the AICPA National Conference on Banks & Saving Institutions," Wesley Bricker, 17 September 2018, <https://www.sec.gov/news/speech/speech-bricker-2018-09-17>, accessed February 2019.

16. "Statement on Digital Asset Securities Issuance and Trading," Division of Corporation Finance, Division of Investment Management and Division of Trading and Markets, US Securities and Exchange Commission, 16 November 2018, <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>, accessed February 2019.

17. SEC's 2018 Annual Report, Division of Enforcement, 2 November 2018, <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>, accessed January 2019.

18. "Testimony on 'Oversight of the U.S. Securities and Exchange Commission,'" Jay Clayton, Committee on Banking, Housing and Urban Affairs, United States Senate, 11 December 2018, <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0>, accessed February 2019.



► **Shareholder engagement through the shareholder proposal process**

Clayton has indicated that he believes the Commission should consider reviewing the ownership and resubmission thresholds and related criteria for shareholder proposals.¹⁹ He has noted that “a lot has changed since” the ownership threshold was adopted 20 years ago and the resubmission thresholds were established in 1954.

► **Role of proxy advisory firms**

Clayton has suggested that the Commission should consider addressing conflicts of interest at proxy advisory firms as well as mechanisms to ensure “that investors have effective access to issuer responses to information in certain reports from proxy advisory firms.”²⁰ Another priority area is providing “greater clarity regarding the division of labor, responsibility and authority between proxy advisors and the investment advisers they serve.”²¹

Notably, while the SEC currently has the authority to regulate proxy advisors, some members of Congress have pursued legislative reforms as well. For example, in November 2018, a U.S. Senate bill was introduced that would fold proxy advisors into existing regulations aimed at investment advisers, including periodic SEC examinations. Legislation on proxy advisors would have to be reintroduced in the current Congress to advance.

5. Enforcement continues to focus on retail investor protection, emerging technologies and individual accountability

Expected action in 2019: continued focus on securities law violations that significantly harm retail investors, relate to FinTech or involve gatekeepers, such as lawyers and accountants, and individual accountability, including executives and directors

SEC enforcement under Clayton continues to focus on retail fraud and digital technologies. The key goals of the Division of Enforcement include deterring securities law violations by pursuing cases that send important signals to the market, return lost assets to injured investors and hold individuals accountable.

Focus on retail investors: As articulated in its FY18 [Annual Report](#), the division’s first principle is “focus on the Main Street investor.” More than half of the stand-alone enforcement actions brought by the SEC in FY18 involved wrongdoing against retail investors. The division’s Retail Strategy Task Force (RSTF), created in September 2017, focuses on data analysis to generate investigative leads on practices in the securities markets that harm retail investors.

19. A shareholder must own \$2,000 worth of a company’s stock for one year to submit a shareholder proposal. Companies can exclude resubmitted shareholder proposals if they received less than 3% of shareholder votes if proposed once in the past five years, less than 6% of the vote if proposed twice during the past five years or less than 10% of shareholder votes if proposed three or more times within the past five years. 17 CFR §240.14a-8.

20. “Testimony on ‘Oversight of the U.S. Securities and Exchange Commission,’” Jay Clayton, Committee on Banking, Housing and Urban Affairs, United States Senate, 11 December 2018, <https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0>, accessed February 2019.

21. Ibid.



Inadequate disclosures by companies of cybersecurity risks and incidents: Clayton has emphasized to SEC registrants the importance of identifying and managing cybersecurity risks and, as noted above, the need to appropriately disclose those risks and incidents in SEC filings. The Commission brought charges for the first time against a public company “for failing to properly inform investors about what was then the largest known cyber intrusion in history.”²²

Prevention of cyber fraud through internal controls: The SEC has warned of frauds that exploit human errors and weak policies and procedures to compromise controls relating to payments, resulting in the loss of millions of dollars. In an October 2018 [report](#), the SEC describes nine companies that experienced this type of fraud and the Division of Enforcement’s consideration of whether the companies violated the securities laws by failing to have proper internal accounting controls.²³ While the SEC ultimately decided not to pursue enforcement actions against the companies, the report notes the importance of maintaining effective internal controls, which is required by the federal securities laws. The report also urges issuers to reassess the adequacy of their controls in light of emerging risks.

Holding individuals accountable: The Enforcement Division has [observed](#) that holding individuals accountable is a “key pillar of any strong enforcement program.”²⁴ Avakian has [noted](#) a continued SEC emphasis on “individual accountability by pursuing charges against individuals for misconduct in the securities markets,

including registered individuals, executives at all levels of the corporate hierarchy, including CEOs, CFOs and other high-ranking executives, and gatekeepers.”

In FY18, the Commission charged individuals “in more than 70% of the standalone enforcement actions it brought.”²⁵

Going forward, we expect the SEC to maintain its focus on audit committees and other gatekeepers, such as lawyers and accountants, to protect the integrity of the capital markets.

Conclusion

Clayton has laid out a clear agenda for 2019 that builds on previous actions, which could result in significant rulemaking during the calendar year. Investors, issuers and board members may want to take advantage of opportunities to engage with the Commission through the comment process or direct contact to provide input as the SEC continues to demonstrate steady progress across its range of priorities.

22. SEC’s 2018 [Annual Report](#), Division of Enforcement, 2 November 2018, <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>, accessed January 2019.

23. “Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding Certain Cyber-Related Frauds Perpetrated Against Public Companies and Related Internal Accounting Controls Requirements,” US Securities and Exchange Commission, 16 October 2019, <https://www.sec.gov/litigation/investreport/34-84429.pdf>, accessed February 2019.

24. Ibid.

25. “Measuring the Impact of the SEC’s Enforcement Program,” Stephanie Avakian, 20 September 2018, <https://www.sec.gov/news/speech/speech-avakian-092018>, accessed February 2019.



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