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# SEC top 10

What public companies,  
boards and investors should  
watch for in 2018

The U.S. Securities and Exchange Commission (SEC) under Chairman Jay Clayton's leadership enters 2018 with a full slate of commissioners and a clear focus on capital formation. Also high on the SEC's agenda are cybersecurity and enforcement of the securities laws. A new dynamic at the Commission in 2018 is the December 2017 confirmation of Commissioners Hester Peirce, a Republican, and Robert Jackson Jr., a Democrat, both of whom will bring new perspectives on these issues. While the SEC's agenda is unlikely to change dramatically as a result of their confirmation, the participation of Peirce and Jackson in the Commission could impact how and when the SEC takes action on certain SEC initiatives.

The following are 10 issues to watch at the SEC that may be of interest to issuers, boards and investors, including views expressed by the new commissioners.

## The SEC is at full strength for the first time in two years with the addition of two commissioners.

The policy effects of the two commissioners will be seen in the coming months. With a full slate of five commissioners, Clayton has the ability to advance his agenda through rule-making with the support of two commissioners, although he may still seek to achieve consensus among the full Commission. An early indication of the priorities and interests of Peirce and Jackson was revealed during their October confirmation hearing before the Senate Committee on Banking, Housing and Urban Affairs, including several areas where they appear to share Clayton's goals.

### Background and views of the new commissioners:

**Hester Peirce:** Prior to joining the SEC, Peirce was a senior research fellow at the Mercatus Center at George Mason University, where her primary research focus was on the regulation of financial markets. She also was Director of the center's Financial Markets Working Group. Prior to serving in these roles at the Mercatus Center, she served as senior counsel for the Senate Committee on Banking, Housing and Urban Affairs. She also has prior experience at the SEC as counsel to former Commissioner Paul Atkins and as a staff attorney in the Division of Investment Management.

**Views on SEC priorities:** At her nomination hearing, Peirce stated that top SEC priorities should include supervision and oversight of firms and self-regulatory organizations through the Office of Compliance Inspections and Examinations (OCIE). She also indicated that the SEC should prioritize addressing problems with equity and fixed income market structure. Cybersecurity is another area she indicated that the SEC should monitor closely.

**Robert Jackson Jr.:** Commissioner Jackson joins the SEC from the New York University (NYU) School of Law, where he was a professor of Law. He previously was a Law professor at Columbia University and Director of the school's Program on Corporate Law and Policy. His work at Columbia included the empirical study of executive compensation and corporate governance matters. He also co-chaired a group that petitioned the SEC in 2011 to mandate that public companies disclose their political spending. Prior to joining Columbia in 2010, Jackson served as an advisor to senior officials at the Treasury Department and in its Office of the Special Master for TARP Executive Compensation.<sup>1</sup> In September 2017, NYU Law School announced that Jackson would rejoin its permanent faculty after serving as SEC Commissioner.

**Views on SEC priorities:** Jackson also indicated that cybersecurity should be a priority for the SEC. More broadly, he stated that securities rules and regulations should keep up with the changing marketplace, and expressed interest in the role of technology in both enhancing corporate reporting and making enforcement efforts more effective and efficient. Another of his priorities is for the SEC to complete pending rules mandated by the Dodd-Frank Act of 2010, in particular several as-yet unfinished rules relating to executive compensation.

## Capital formation is at the heart of Clayton's priorities, reflecting his goal of ensuring that retail investors continue to benefit from the public capital markets.

A high priority for Clayton is promoting capital formation. Clayton has expressed concern about the lower numbers of IPOs in recent years – particularly those of small- and medium-sized companies – and the correspondingly fewer investment options for “Mr. and Ms. 401(k).”<sup>2</sup> Another detrimental impact of having fewer public companies identified by Clayton is that “there will be less publicly available information about the operations and performance of companies that are important to our economy.”<sup>3</sup>

While Clayton has acknowledged the benefits to the US economy from the growth of the private capital markets, he wants to focus on increasing the attractiveness of the public capital markets. One reason Clayton has cited for the reduced attractiveness of the public markets is the disparate regulatory burden and costs on public companies, compared with privately held companies.<sup>4</sup>



1. The Troubled Asset Relief Program (TARP) was established by the U.S. Treasury Department to stabilize the economy following the 2008 financial crisis.  
 2. “Remarks at the Economic Club of New York,” Jay Clayton, 12 July 2017, <https://www.sec.gov/news/speech/remarks-economic-club-new-york>, accessed November 2017.  
 3. “Governance and Transparency at the Commission and in Our Markets,” remarks at the Practising Law Institute (PLI) 49th Annual Institute on Securities Regulation, Jay Clayton, 8 November 2017, <https://www.sec.gov/news/speech/speech-clayton-2017-11-08>, accessed November 2017.  
 4. “Testimony on Examining the SEC's Agenda, Operation and Budget,” Jay Clayton, Committee on Financial Services, United States House of Representatives, 4 October 2017, <https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget>, accessed November 2017.

**“It is clear to me that companies that go through the U.S. IPO process emerge as better companies, with better disclosure.”**

Chairman Jay Clayton,

“Testimony on Examining the SEC’s Agenda, Operation and Budget,” Committee on Financial Services, United States House of Representatives, 4 October 2017.

Clayton has directed the SEC to take certain actions to make it easier for companies to go public, such as accepting draft registration statements from all companies conducting IPOs for nonpublic review and permitting certain financial information to be omitted from draft registration statements, regardless of size.<sup>5</sup> Previously, only emerging growth companies (EGCs) and certain foreign private issuers were able to submit draft registration statements. Clayton also has suggested that scaled disclosure and regulatory requirements depending on issuer size are one way of “restoring vibrancy” to the capital market, as this will help reduce the incentives to stay private.<sup>6</sup> To this end, the staff is working on a final rule to modify the thresholds for smaller reporting companies that would expand the number of companies eligible for scaled disclosure requirements.<sup>7</sup>

**New commissioner views:** Peirce in particular appears to support Clayton’s focus on capital formation, noting in her testimony the benefits of retail investor access to a range of types of investments, including in small, publicly traded companies. Peirce also emphasized the importance of regulatory flexibility to foster innovation, which can benefit investors, companies and markets.

**Financial regulatory reform:** Clayton’s agenda is consistent with several recommendations in a report issued in October by the U.S. Treasury Department on financial regulatory reform.<sup>8</sup> This report is the second in a series of reports that recommend changes to the financial system based on the Trump Administration’s “core principles” on the financial system.<sup>9</sup> The October report focuses on capital market rules overseen by the SEC and the Commodity Futures Trading Commission, among other bodies. The report recommends certain changes that reflect areas in which Clayton has already indicated that he will take action, such as modernizing and streamlining disclosure requirements and scaling disclosure requirements for smaller reporting companies.<sup>10</sup> The report also recommends that the SEC take additional measures to promote capital formation, including:

- ▶ Allowing non-EGCs to “test the waters” before an IPO to determine the level of interest in an offering among qualified institutional buyers and accredited institutional investors
- ▶ Expanding Regulation A+ to facilitate small business capital formation, such as by allowing Exchange Act companies to offer securities under Regulation A, which the report indicates would “provide already public companies with a lower-cost means of raising additional capital ...”<sup>11</sup>

While the SEC is an independent regulator and so controls its own rule-making agenda, the report reflects input by the SEC and could signal future items on the SEC’s agenda.



5. “To the point: SEC staff substantially expands scope of confidential review program for draft registration statements,” Ernst & Young LLP, 6 July 2017, [http://www.ey.com/Publication/vwLUAssetsALToThePoint\\_04157-171US\\_ConfidentialReviewProgram\\_6July2017/\\$FILE/ToThePoint\\_04157-171US\\_ConfidentialReviewProgram\\_6July2017.pdf](http://www.ey.com/Publication/vwLUAssetsALToThePoint_04157-171US_ConfidentialReviewProgram_6July2017/$FILE/ToThePoint_04157-171US_ConfidentialReviewProgram_6July2017.pdf).
6. “Testimony on Examining the SEC’s Agenda, Operation and Budget,” Jay Clayton, Committee on Financial Services, United States House of Representatives, 4 October 2017, <https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget>, accessed November 2017.
7. The proposed rule was issued in June 2016. “Amendments to smaller reporting company definition,” Securities and Exchange Commission, 27 June 2016, <https://www.sec.gov/rules/proposed/2016/33-10107.pdf>, accessed November 2017.
8. “A Financial System That Creates Economic Opportunities - Capital Markets,” U.S. Treasury Department, October 2017, <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>, accessed November 2017.
9. “Presidential Executive Order on Core Principles for Regulating the United States Financial System,” 3 February 2017, <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executiveorder-core-principles-regulating-united-states>, accessed November 2017.
10. “A Financial System That Creates Economic Opportunities - Capital Markets,” U.S. Treasury Department, October 2017, <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>, accessed November 2017.
11. Ibid.

## Clayton is continuing the Commission's work on disclosure effectiveness that began under former SEC Chair Mary Jo White.

The purpose of the disclosure effectiveness initiative is to modernize and simplify disclosure requirements. Clayton views this project as a means of promoting capital formation, as it could reduce the regulatory burden associated with being a public company. Clayton has further noted his view that disclosure requirements should reflect how businesses are run and not force companies into a one-size-fits-all mold. In discussing potential disclosure changes, Clayton also has emphasized the need to ensure that investors still receive all material information.

The SEC is taking steps to revise disclosure requirements to achieve these goals. For example, the SEC issued a rule proposal in October that would allow reporting companies to omit or limit their discussion in Management's Discussion & Analysis of the earliest of the three years in the financial statements. The proposal also would allow companies to redact certain immaterial confidential information from exhibits included in public filings without obtaining SEC staff approval in advance.<sup>12</sup> Clayton has highlighted that benefits of this change include reducing processing time for issuers and strain on SEC staff resources. It also helps keep proprietary data under the company's control.

Clayton has indicated that the SEC staff is finalizing additional disclosure-related projects, including final rule amendments to eliminate redundant, outdated or superseded disclosure requirements, originally proposed in July 2016. Another staff project involves possible changes to certain financial statement requirements for entities other than the issuer under Regulation S-X.<sup>13</sup> Work is also proceeding to update industry-specific disclosure requirements for mining and bank holding companies.

## Cybersecurity is taking on greater prominence throughout the SEC's work – with a particular focus on company disclosures, cybercrime and the bolstering of cybersecurity in the SEC's internal operations.

Two recent cyber-related developments greatly increased congressional and market scrutiny of the SEC: (1) the theft of millions of individuals' personal information from Equifax, an SEC-registered issuer, and (2) the hack of the SEC's EDGAR database, which houses documents submitted to the SEC for regulatory and disclosure purposes.

These events appear to have further stimulated the SEC's efforts relating to cybersecurity, which Clayton has identified as a priority since his confirmation hearing. One step was to establish a Cyber Unit in the Division of Enforcement (see discussion of the Cyber Unit in the next section). Disclosure of cyber risks and incidents also is receiving a more critical assessment.<sup>14</sup> Clayton has continuously messaged his concerns that market participants are not adequately disclosing their cyber risks to investors. He has emphasized to SEC registrants the importance of identifying and managing cybersecurity risks as well as the need to appropriately disclose those risks and incidents in SEC filings.

While no explicit changes in policy have occurred to date, the Director of the SEC's Division of Corporation Finance, William Hinman, has publicly noted that the SEC is considering updating the agency staff's [2011 cybersecurity guidance](#)<sup>15</sup> in certain areas, while affirming that the guidance is still applicable. Areas of potential change include specific guidance about insider trading as well as on disclosure controls and procedures to ensure that cyber incidents are appropriately elevated to consider the need for timely disclosure. In the meantime, Hinman has advised companies to review their insider trading policies when there has been a cyber intrusion.<sup>16</sup>

12. "To the Point: SEC proposes modernizing and simplifying certain Regulation S-K disclosure requirements," Ernst & Young LLP, 12 October 2017, [http://www.ey.com/Publication/vwLUAssetsAL/ToThePoint\\_05841-171US\\_SECModernizationRegulationS-K\\_12October2017/\\$FILE/ToThePoint\\_05841-171US\\_SECModernizationRegulationS-K\\_12October2017.pdf](http://www.ey.com/Publication/vwLUAssetsAL/ToThePoint_05841-171US_SECModernizationRegulationS-K_12October2017/$FILE/ToThePoint_05841-171US_SECModernizationRegulationS-K_12October2017.pdf). These changes were developed following an SEC study on disclosure modernization and simplification, which was required by the Fixing America's Surface Transportation (FAST) Act and completed in November 2016.

13. Specifically, the staff is considering whether to recommend that the SEC propose changes to the financial statement disclosure requirements under Rules 3-05 and 3-10 of Regulation S-X based on comments received in response to its 2015 "Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Issuer and to Registrant."

14. "SEC Reporting Update: Spotlight on cybersecurity disclosures," Ernst & Young LLP, 16 November 2017, [http://www.ey.com/Publication/vwLUAssetsAL/SECReportingUpdate\\_06544-171US\\_Cybersecurity\\_16November2017/\\$FILE/SECReportingUpdate\\_06544-171US\\_Cybersecurity\\_16November2017.pdf](http://www.ey.com/Publication/vwLUAssetsAL/SECReportingUpdate_06544-171US_Cybersecurity_16November2017/$FILE/SECReportingUpdate_06544-171US_Cybersecurity_16November2017.pdf).

15. CF Disclosure guidance: Topic No. 2 – Cybersecurity, 13 October 2011, <https://www.sec.gov/divisions/corptfin/guidance/cfguidance-topic2.htm>, accessed December 2017.

16. Ezequiel Minaya, "SEC Says Companies Can Expect New Guidelines on Reporting Cybersecurity Breaches," WSJ.com, 9 November 2017, <https://www.wsj.com/articles/sec-says-companies-can-expect-new-guidelines-on-reporting-cybersecurity-breaches-1510267201>, accessed November 2017.

**“Despite the attention given to widely-publicized cyber-related incidents experienced by the Commission and others, I still am not confident that the Main Street investor has received a sufficient package of information from issuers, intermediaries and other market participants to understand the substantial risks resulting from cybersecurity and related issues. As a general matter, it is critical that investors be informed about the threats that issuers and other market participants face.”**

Chairman Jay Clayton,

“Testimony on Examining the SEC’s Agenda, Operation and Budget,” Committee on Financial Services, United States House of Representatives, 4 October 2017.

Clayton also is encouraging regulators and the private sector to communicate and work together in combating cyber threats to protect the financial system. In October testimony before the U.S. House of Representatives Committee on Financial Services, Clayton stated: “Information sharing and coordination are essential for regulators to anticipate potential cyber threats and respond to a major cyberattack, should one arise. The SEC is therefore working closely with fellow financial regulators to improve our ability to receive critical information and alerts, react to cyber threats and harmonize regulatory approaches.”<sup>17</sup>

With regard to the EDGAR hack, the SEC is investigating how the intrusion happened and whether any trading was conducted based on information obtained from EDGAR. The SEC also has work streams to upgrade the SEC’s overall cybersecurity policies in addition to those relating to EDGAR.

**New commissioner views:** Peirce and Jackson both highlighted cybersecurity as a priority for the SEC at their confirmation hearing and indicated that companies should carefully consider their cybersecurity-related disclosures. Jackson noted the changing cybersecurity environment, stating: “I think the risks that companies face on the cybersecurity front today are different than they were even just a few years ago. And my concern is that we make sure that the rules they face and the disclosures they provide to investors keep pace with those changes.”<sup>18</sup> Jackson further suggested that the SEC should consider providing guidance to companies regarding what is material to investors today in light of the changes.

## **SEC enforcement under Clayton is shifting focus to digital technologies and retail fraud and away from the “broken windows” approach – but remains a top priority for the SEC.**

Clayton and Division of Enforcement Co-Directors Stephanie Avakian and Stephen Peikin have indicated that they expect substantial continuity in the SEC’s Enforcement program. At the same time, they are placing increased emphasis on two areas in particular – retail investors and cyber investigations – while operating under a general hiring freeze.

**Cyber investigations:** Reflecting heightened concerns about cybersecurity, a new Cyber Unit has been created in the Division of Enforcement. Avakian has said the Cyber Unit will focus its investigations on three types of cases:<sup>19</sup>

- ▶ Cyber-related misbehavior intended to obtain a market advantage – For example, the SEC already has brought cases that involved account intrusions and used social media to disseminate false information.
- ▶ Failure of SEC-registered entities to take sufficient measures to safeguard information or the integrity of IT systems – Avakian has stated that Enforcement works closely with OCIE to determine whether an examination or investigation is the best approach in a given inquiry.
- ▶ Inadequate disclosures of cyber events by companies – Avakian has stated that the SEC will not second-guess reasonable disclosure decisions made in good faith, although a future enforcement action in extreme circumstances is possible. Clayton has also expressed caution about blaming companies that are the victims of “sophisticated cyber penetrations.”<sup>20</sup>

17. “Testimony on Examining the SEC’s Agenda, Operation and Budget,” Jay Clayton, Committee on Financial Services, United States House of Representatives, 4 October 2017, <https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget>, accessed November 2017.

18. Transcript for confirmation hearing of Hester Peirce and Robert Jackson Jr. before the Senate Committee on Banking, Housing and Urban Affairs, 24 October 2017, available at [cq.com](http://cq.com).

19. “The SEC Enforcement Division’s Initiatives Regarding Retail Investor Protection and Cybersecurity,” Stephanie Avakian, 26 October 2017, <https://www.sec.gov/news/speech/speech-avakian-2017-10-26>, accessed November 2017.

20. “Remarks at the Economic Club of New York,” Jay Clayton, 12 July 2017, <https://www.sec.gov/news/speech/remarks-economic-club-new-york>, accessed November 2017.

The Cyber Unit also is handling investigations into initial coin offerings and distributed ledger technology. So far, public SEC actions and statements in this area have primarily served to remind issuers of the need to register initial coin and similar offerings with the SEC unless a valid exemption applies. Several offerings have been withdrawn following such warnings. Clayton and SEC staff also have advised investors to be cautious when investing in these new types of offerings.<sup>21</sup>

**Focus on retail:** The Division of Enforcement created its Retail Strategy Task Force, which will seek to generate investigative leads using data analytics. The task force generally will not conduct its own investigations, but will identify areas at risk for abusive practices and provide those leads to others in Enforcement.

It remains to be seen how significantly the SEC's portfolio of investigations will shift as a result of the task force, as many SEC Enforcement cases address misbehavior that harms retail investors, such as Ponzi schemes and microcap fraud. Avakian indicated that aside from these "traditional" retail investigations, the task force will also look out for "conduct that occurs at the intersection of investment professionals and retail investors."<sup>22</sup> This could include cases alleging that investors were harmed through the sale of higher-fee mutual funds, charges for excessive trading or inadequate disclosure of the risks of investing in complex securities.

Other developments:

- ▶ Peikin has indicated that the Division of Enforcement will end the "broken windows" approach implemented under former Chair White, in which the SEC pursued the simultaneous investigation and resolution of a large number of minor violations. The division's focus may shift to bringing a smaller number of cases that will send a message to market participants instead.

- ▶ Peikin has signaled that the SEC may reduce the number of cases in which it seeks admissions of wrongdoing from persons and entities as part of the resolution of an enforcement action. This policy had been implemented only in a small percentage of the SEC's cases.
- ▶ The amount of monetary relief obtained by the SEC may drop significantly. One reason is the recent Supreme Court decision in *Kokesh v. SEC*, which held that the SEC cannot seek disgorgement of "ill-gotten gains" for securities law violations beyond the five-year statute of limitations.<sup>23</sup> Another is that this Commission may more closely scrutinize the justification for corporate penalties than in recent years and may not as readily approve penalties unless there is a clearly identifiable benefit to the corporation from the misconduct.
- ▶ The division released an annual report for FY17 in which Avakian and Peikin set out core principles for the division going forward. In addition to their focus on retail and cyber issues as discussed above, the Co-Directors highlighted that the division will seek to hold individuals accountable for wrongdoing where possible because doing so has a strong deterrent effect.

**Views of new commissioners:** The new commissioners appear to share the view that the SEC should have a strong enforcement program. During their confirmation hearings, both Peirce and Jackson referred to their belief that individual accountability has a greater deterrent effect than large corporate penalties, echoing the approach being taken by the Division of Enforcement. Jackson suggested that ensuring individual accountability could require a change in the law to introduce a lower standard of proof. Peirce expressed a concern that corporations might be too quick to settle an enforcement action using shareholder assets in order to take the focus off of executives. She further noted, "If something has been done wrong, an individual is involved."



21. See, e.g., "Statement on Cryptocurrencies and Initial Coin Offerings," Jay Clayton, 11 December 2017, <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>, accessed December 2017.

22. "The SEC Enforcement Division's Initiatives Regarding Retail Investor Protection and Cybersecurity," Stephanie Avakian, 26 October 2017, <https://www.sec.gov/news/speech/speech-avakian-2017-10-26>, accessed November 2017.

23. Specifically, *Kokesh* held that the five-year statute of limitations for civil penalties applies to disgorgement of "ill-gotten gains" because disgorgement is punitive in nature. Prior to this, the SEC considered disgorgement to be remedial rather than punitive in nature and therefore was not subject to the statute of limitations. *Kokesh v. SEC*, No. 16-529, slip op. at 2-3 (U.S. June 5, 2017).

## Pending Dodd-Frank Act rules will be addressed, although timing is unclear.

Certain corporate governance and other rules mandated by the Dodd-Frank Act of 2010 have not yet been finalized and require SEC action. These include final rules to require companies to “claw back” executive compensation in cases of financial restatements, disclose how executive pay is tied to company performance, and disclose whether companies allow hedging by employees, officers and directors to offset decreases in the market value of company securities.<sup>24</sup> Clayton has indicated these rule-makings are not on his short-term agenda, but he is quick to add that they are “top of mind”<sup>25</sup> and that he intends to carry out the legislative mandate.

**Pay ratio guidance:** The SEC hinted that it may take a pragmatic approach to future Dodd-Frank rule-making when it issued interpretive guidance on implementation of the Dodd-Frank-mandated CEO pay ratio rule in September. The pay ratio rule requires companies to disclose the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer or other principal executive officer. In the [press release](#) announcing the interpretive guidance, Clayton stated, “It’s our priority to make sure that we implement disclosure rules mandated by Congress in a way that is true to the mandate and, to the extent practicable, allows companies to use operational data and otherwise readily available information to produce the disclosures.” The guidance also states that the SEC staff won’t bring enforcement actions challenging pay ratio disclosures based on estimates made in good faith. The first pay ratio disclosure is due in 2018 regarding companies’ fiscal years that began in 2017.

**New commissioner views:** Jackson indicated that he considers the corporate governance-related Dodd-Frank rules to be a top priority in light of their importance for investor protection. While Peirce noted that the SEC should carry out rule-making required by legislation, she would not commit to making it a top priority before getting to the SEC and considering the full range of priorities before the Commission.

## The SEC has announced five new members of the Public Company Accounting Oversight Board (PCAOB), potentially affecting the direction of the PCAOB.

The SEC [announced](#) in December the appointments of the next PCAOB Chairman, William (Bill) Duhnke III, as well as four new Board Members, replacing all members of the PCAOB’s governing body. The PCAOB promulgates audit standards, conducts audit firm inspections and investigates potential wrongdoing by auditors of public companies and broker-dealers. Clayton issued an accompanying [statement](#) in which he highlighted that “the new Board’s collective experience spans the phases of the financial reporting process ... .” He also indicated that the new Board Members would begin taking their seats in January 2018. The names and brief biographies of the incoming PCAOB Chairman and Board Members, respectively, are below:

- ▶ Bill Duhnke has had a long career on the Senate staff, serving currently as the Staff Director of the Senate Rules Committee. Duhnke also has served as senior staff on several other Senate committees, including Staff Director/General Counsel of the Senate Banking, Housing and Urban Affairs Committee. Prior to serving in congressional roles, Duhnke served in the Navy.
- ▶ J. Robert (Jay) Brown is a professor of Law at the University of Denver, where he is Director of the Corporate and Commercial Law program and is the Lawrence W. Treece Professor of Corporate Governance. Since the beginning of 2017, he has served on the PCAOB Standing Advisory Group.
- ▶ Duane M. DesParte is a senior vice president and Corporate Controller of Exelon. Prior to joining Exelon, he was an audit partner at Deloitte & Touche and Arthur Andersen.
- ▶ Kathleen Hamm is the Global Leader of Securities and Fintech Services and Senior Strategic Adviser to the CEO on Cyber Solutions at Promontory Financial Group. She previously held positions at the U.S. Treasury Department, where she worked on cybersecurity and financial sector risk management issues, as well as in the SEC’s Division of Enforcement.
- ▶ James G. Kaiser is an audit partner and the Global Assurance Methodology and Transformation Leader at PwC. He also leads the global team responsible for developing and implementing the digital strategy for the future of audit and assurance and is responsible for the development of PwC’s audit policies and practices for international auditing standards.

24. These rules are required by sections 954, 953(a) and 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, respectively.

25. “Governance and Transparency at the Commission and in Our Markets,” remarks at the PLI 49th Annual Institute on Securities Regulation, Jay Clayton, 8 November 2017, <https://www.sec.gov/news/speech/speech-clayton-2017-11-08>, accessed November 2017.

In announcing the new appointments, Clayton praised the PCAOB for “improving the quality and reliability of public company audits for the protection of investors.”<sup>26</sup> He also has emphasized the critical role of the PCAOB’s leadership in establishing high-quality auditing standards in the US and promoting similar efforts around the world by collaborating with international auditing standard setters.<sup>27</sup>

## The SEC plans to closely monitor the implementation of the PCAOB’s new rule on the auditor’s report.

The SEC approved the PCAOB’s new rule revising the auditor’s reporting model in October. In doing so, Clayton indicated that the SEC will closely monitor its implementation. The new rule will require auditors to disclose certain new information, including about auditor tenure, in auditor’s reports relating to financial reporting periods ending on or after 15 December 2017. Beginning in 2019, auditors of large accelerated filers also will be required to include a discussion of critical audit matters (CAMs) in their reports. CAMs are matters communicated or required to be communicated to audit committees and that relate to accounts or disclosures material to the financial statements and involve especially challenging, subjective or complex auditor judgment.<sup>28</sup>

In a statement accompanying the SEC approval of the standard, Clayton noted his strong support for “the objective of the rule to provide investors with meaningful insights into the audit from the auditor.”<sup>29</sup> He has warned of the need to avoid boilerplate, however, which would reduce the usefulness of the reports. SEC staff have emphasized the need for all stakeholders – preparers, audit committees and auditors – to participate in the development of CAMs to realize the full benefits of the changes. In recent remarks, Clayton encouraged audit committees to ask their auditors to do a “dry run” of the expanded auditor’s report and the related CAMs before they are filed publicly.<sup>30</sup>

Clayton also has acknowledged the concerns of some commenters on the PCAOB rule about the potential for increased litigation and strained auditor-audit committee relationships as a result of the rule. In discussing the new standard, Clayton has highlighted the importance of the role of audit committees and his concern about potential damage to that role. He also noted that the SEC order approving the auditor’s reporting standard calls for the PCAOB to carry out a timely post-implementation review to determine any unintended consequences and has “directed the SEC staff to assist in that process.”<sup>31</sup>

**“The independent audit committee has emerged as one of the most significant and efficient drivers of value to Main Street investors. The audit committee’s key role in the oversight of the audit and the auditor, and in the integrity of a company’s accounting and financial reporting processes, has significantly enhanced financial reporting quality. Impairing or otherwise negatively affecting the work of well-functioning audit committees could have significant adverse effects on investors.”**

Chairman Jay Clayton,

“Statement on SEC Approval of the PCAOB’s New Auditor’s Reporting Standard,” 23 October 2017.

26. “Statement on Appointment of New PCAOB Board Members,” Jay Clayton, 12 December 2017, <https://www.sec.gov/news/public-statement/clayton-2017-12-12>, accessed December 2017.

27. Jay Clayton’s remarks at the 2017 American Institute of Certified Public Accountants (AICPA) Conference on SEC and PCAOB Developments. See “2017 AICPA Conference on SEC and PCAOB Developments: Compendium of significant accounting and reporting issues,” 10 December 2017, Ernst & Young LLP, [http://www.ey.com/Publication/vwLUAssets/AL/AICPACompendium\\_06875171US\\_10December2017/\\$FILE/AICPACompendium\\_06875-171US\\_10December2017.pdf](http://www.ey.com/Publication/vwLUAssets/AL/AICPACompendium_06875171US_10December2017/$FILE/AICPACompendium_06875-171US_10December2017.pdf).

28. “To the point: PCAOB adopts final standard to significantly change the auditor’s report,” Ernst & Young LLP, 5 June 2017, [http://www.ey.com/Publication/vwLUAssets/AL/ToThePoint\\_03611-171US\\_ARMStandard\\_5June2017/\\$FILE/ToThePoint\\_03611-171US\\_ARMStandard\\_5June2017.pdf](http://www.ey.com/Publication/vwLUAssets/AL/ToThePoint_03611-171US_ARMStandard_5June2017/$FILE/ToThePoint_03611-171US_ARMStandard_5June2017.pdf). 29. “Statement on Appointment of New PCAOB Board Members,” Jay Clayton, 12 December 2017, <https://www.sec.gov/news/public-statement/clayton-2017-12-12>, accessed December 2017.

30. “2017 AICPA Conference on SEC and PCAOB Developments: Compendium of significant accounting and reporting issues,” 10 December 2017, Ernst & Young LLP, [http://www.ey.com/Publication/vwLUAssets/AL/AICPACompendium\\_06875-171US\\_10December2017/\\$FILE/AICPACompendium\\_06875-171US\\_10December2017.pdf](http://www.ey.com/Publication/vwLUAssets/AL/AICPACompendium_06875-171US_10December2017/$FILE/AICPACompendium_06875-171US_10December2017.pdf).

31. “Statement on Appointment of New PCAOB Board Members,” Jay Clayton, 12 December 2017, <https://www.sec.gov/news/public-statement/clayton-2017-12-12>, accessed December 2017.

## The SEC plans to give the proxy process another look in light of dissatisfaction from both issuers and shareholders.

Clayton has indicated that he may reopen a review of the US proxy process to assess whether it is meeting the needs of long-term “Main Street” investors and companies. In November remarks, Clayton suggested the SEC may revisit its 2010 “proxy plumbing” concept release and highlighted several issues that may need review.<sup>32</sup> One of these is retail shareholders’ lack of participation in the proxy process. Clayton noted the high percentage of public company shares owned directly or indirectly by long-term retail shareholders and questioned whether these shareholders’ interests are being fully represented in SEC rule-making. Noting that investment advisers often vote on behalf of their Main Street investor clients, Clayton asked whether the views of those investors “are being advocated fully and clearly, either by individual investors or the groups that represent them.” He also noted that retail shareholders often do not vote their shares, which may indicate that the proxy voting process is too cumbersome. Another issue flagged by Clayton is that neither shareholders nor companies are satisfied with the shareholder proposal process. The SEC may seek to find common ground to address concerns about both shareholder lack of influence over company matters as well as costs of the shareholder proposal process.

**New commissioner views:** During his confirmation hearing, Jackson supported balancing the needs of shareholders and management with respect to shareholder proposals. He also supported reviewing whether the SEC should increase the share threshold necessary for an investor to resubmit a shareholder proposal that has been voted down in the past, stating: “... I’m someone who’s very focused on dialogue between shareholders and management. And, I think, as long as we can advance that goal but minimize the repetitive proposals that consume corporate management’s time and cost, I think that would be a good way forward.”<sup>33</sup>

## Clayton plans to provide transparency and accountability with respect to the SEC agenda, committing to a reduced number of attainable projects.

Since taking office, Clayton has taken a measured approach to advancing his key priorities, reflecting the principles he outlined in a policy speech in July that he said would guide his actions at the SEC.<sup>34</sup> These include taking account of the cumulative impact of regulations as well as being aware that regulatory change – while necessary to keep up with evolving markets – has costs that are borne by all market participants.

Clayton gave further definition of his approach to SEC rule-making in a November speech when he stated that he plans to provide transparency and accountability regarding the SEC agenda. While affirming that the SEC is not slowing its activities, Clayton indicated that he will only place rule-making projects on the SEC’s active agenda that SEC leadership believes can realistically get done. One place where this philosophy will be manifest is in the SEC’s new five-year strategic plan that will be issued in January. Clayton indicated that the plan will be streamlined to “reflect what we need to do, what we should do, and what we believe we can do.”<sup>35</sup>

“We should endeavor to be transparent to Congress, investors, issuers and other interested parties about what rules we intend to pursue and have a reasonable expectation of completing over the coming year. And then, we must set forth to do it.”

Chairman Jay Clayton,

“Governance and Transparency at the Commission and in Our Markets,” remarks at the PLI 49th Annual Institute on Securities Regulation, 8 November 2017.

32. “Governance and Transparency at the Commission and in Our Markets,” remarks at the PLI 49th Annual Institute on Securities Regulation, Jay Clayton, 8 November 2017, <https://www.sec.gov/news/speech/speech-clayton-2017-11-08>, accessed November 2017.

33. Transcript for confirmation hearing of Hester Peirce and Robert Jackson before the Senate Committee on Banking, Housing and Urban Affairs, 24 October 2017, available at [cq.com](http://www.cq.com).

34. “New SEC Chairman Jay Clayton outlines views in policy speech,” Ernst & Young LLP, July 2017, [http://www.ey.com/Publication/vwLUAssets/ey-new-sec-chairman-jay-clayton-outlines-views-in-policyspeech/\\$FILE/ey-new-sec-chairman-jay-clayton-outlines-views-in-policy-speech.pdf](http://www.ey.com/Publication/vwLUAssets/ey-new-sec-chairman-jay-clayton-outlines-views-in-policyspeech/$FILE/ey-new-sec-chairman-jay-clayton-outlines-views-in-policy-speech.pdf).

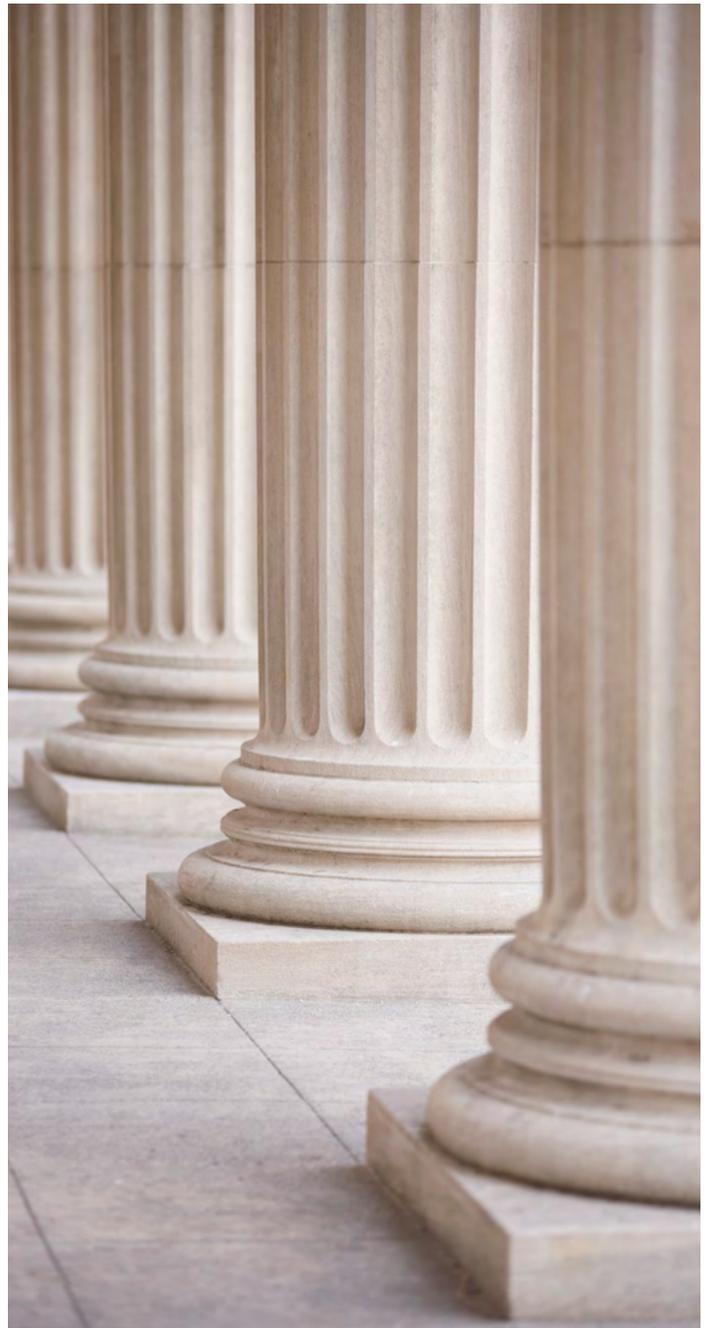
35. “Governance and Transparency at the Commission and in Our Markets,” remarks at the PLI 49th Annual Institute on Securities Regulation, Jay Clayton, 8 November 2017, <https://www.sec.gov/news/speech/speech-clayton-2017-11-08>, accessed November 2017.

One new issue that likely will be on the SEC's short-term agenda in 2018 is the financial reporting impact of US tax reform. Companies will need to account for the change in tax law in the period of enactment (i.e., in the fourth quarter for calendar year-end companies).<sup>36</sup> At a December conference, the SEC staff signalled future action in this area. They acknowledged the challenges companies will face to incorporate the effects of tax reform by their financial reporting deadlines and indicated that consideration will be given to whether SEC action is needed to address those challenges. The staff also emphasized, however, that companies must timely report meaningful information to investors.

**Cost-benefit analysis:** At their confirmation hearing, Peirce and Jackson were asked about their views of the need to examine the costs of regulations in rule-making; both commissioners supported cost-benefit analysis. Peirce stated that, as part of the cost-benefit process, the SEC should determine the problem it is trying to solve and consider different ways to resolve it. She also stated that the SEC should "build in metrics so that [it] can look back and see how the rule is working." In her previous role at the Mercatus Center, Peirce had been critical of the SEC's cost-benefit analyses, writing in a 2012 paper: "The principal securities laws require the SEC to perform economic analysis with respect to many of its rules. The SEC, however, has struggled to implement its statutory mandate."<sup>37</sup> Jackson also expressed support for cost-benefit analysis, although he also noted that it is not perfect and "we should know the limits of what we can know about cost and benefits in any particular case."

### Conclusion

Although SEC rule-making under Clayton has been relatively quiet thus far, it appears that work behind the scenes is paving the way for the new Commission to move forward in a number of areas in 2018. While the new commissioners' impact on the SEC's agenda remains to be seen, companies, investors and other stakeholders should expect SEC action in 2018 on the aforementioned areas.



36. "2017 AICPA Conference on SEC and PCAOB Developments: Compendium of significant accounting and reporting issues," 10 December 2017, Ernst & Young LLP, [http://www.ey.com/Publication\\_vwLUAssets/AL/AICPACompendium\\_06875-171US\\_10December2017/\\$FILE/AICPACompendium\\_06875-171US\\_10December2017.pdf](http://www.ey.com/Publication_vwLUAssets/AL/AICPACompendium_06875-171US_10December2017/$FILE/AICPACompendium_06875-171US_10December2017.pdf).

37. "Working Paper: Economic Analysis by Federal Financial Regulators," Hester Peirce, Mercatus Center, George Mason University, 23 October 2012, [https://www.mercatus.org/system/files/FinancialRegulators\\_Peirce\\_v1-0.pdf](https://www.mercatus.org/system/files/FinancialRegulators_Peirce_v1-0.pdf), accessed November 2017.

## Contacts

### Les Brorsen

EY Americas Vice Chair, Public Policy  
+1 202 327 5968

### Bridget Neill

EY Americas Deputy Vice Chair, Public Policy  
+1 202 327 6297

### Steve Klemash

Americas Leader, EY Center for Board Matters  
Ernst & Young LLP  
+1 412 644 7461

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