

SEC Direction Unlikely To Shift Despite Agency Transitions

By Carol Gilden

Law360 (August 27, 2018) - Elad Roisman has moved one step closer to being sworn in as a U.S. Securities and Exchange Commission member. On Aug. 23, 2018, the Senate Banking Committee approved Roisman as the Republican replacement for former SEC Commissioner Michael Piowar, who stepped down in July after serving as commissioner since 2013, including a four-month stint in 2017 as acting SEC chairman. Roisman is currently chief counsel to the Senate Banking Committee led by Chairman Mike Crapo; he previously served as counsel for former SEC commissioner Daniel Gallagher, and at one time worked in the legal department at NYSE Euronext and as a corporate and securities attorney with Milbank Tweed Hadley & McCloy LLP. Also stepping down this year is Democrat SEC Commissioner Kara Stein.

Stein's potential replacement likely will be Allison Lee, a Democrat, whose name has been submitted to the president, and who previously served as an aide to Stein and is a former SEC enforcement attorney. Despite these forthcoming changes at the SEC, the balance of power and direction of the SEC is unlikely to change, as the SEC remains in Republican hands which, since Donald Trump took office, has translated to the SEC bringing fewer enforcement actions.



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The president, subject to Senate approval, appoints all five commissioners: two Democrats, two Republicans and the chair, who may be of the president's own party. Since the chair is both the SEC's chief executive and the tie-breaking vote, the party that controls the White House also controls the SEC's agenda and direction. While Chairman Jay Clayton is an independent, as a longtime partner at Sullivan & Cromwell LLP specializing in advising clients on public and private mergers and acquisitions and capital-raising efforts, his ideology is viewed as aligning squarely with that of the Republicans. The commissioners' terms last five years and are staggered, with one commissioner's term ending each June 5, although, as with Stein whose term ended June 2017, commissioners may continue to serve an additional 18 months if they are not replaced before then or resign sooner.

Until Piowar's seat is filled, the commission is temporarily deadlocked, with Clayton and Republican Commissioner Hester Peirce on one end of the political spectrum, and two Democrat commissioners, Robert Jackson Jr. and Stein, on the other. Once Roisman is confirmed, the balance will tilt toward the Republicans; indeed, it is expected that Roisman will become an ally of Clayton on many issues. The vote on Roisman's confirmation before the full Senate has not been scheduled, and many believe the Senate is waiting for a Democratic nominee to replace Stein to tee up both nominees for Senate confirmation at the same time, as was done with Peirce and Jackson in 2017. However, there are no guarantees that the

Senate will abide by this tradition, particularly given the current political climate.

The ideology of the chair and the commissioners determines the direction and focus of the SEC's activities, including rule-making and enforcement, as can readily be seen in the issues that the SEC and its commissioners choose to address — and not address. For example, Piwowar suggested last July that the SEC might be willing to consider allowing companies going public to include bylaw provisions requiring mandatory arbitration of securities claims. This idea has since been endorsed by Peirce, whose comments in a recent Politico interview have been the source of consternation to many in the investor community, when she said “mandatory arbitration should be an option for companies.”[1] In contrast, in a speech earlier this year, Jackson said this “is hardly the time to be thinking about depriving shareholders of their day in court”; if investors are barred from seeking court redress, “then the burden of investigating and litigating these cases may fall entirely on the SEC,” and he was “skeptical” of proposals like mandatory arbitration because “they deprive the public of the law our judges make when they hold corporate insiders accountable to investors.”[2] Significantly, the ability of the chair and commissioners to exert their influence over the SEC's direction also was expanded under the U.S. Supreme Court's recent decision in *Lucia v. Securities and Exchange Commission*, as they may now appoint the agency's administrative law judges.

Importantly, the chair and commissioners decide how the SEC should wield its enforcement powers. Since Trump took office, there has been a marked decline in the number of SEC enforcement actions. Though the SEC Division of Enforcement manual states its “mission is to protect investors and the markets by investigating potential violations of the federal securities laws and litigating the SEC's enforcement actions,” the number of SEC enforcement actions against public companies and their subsidiaries declined by 67 percent for the first half of fiscal year 2018 compared to the first half of FY 2017, dropping from 45 actions to 15 actions in 2018, according to a recent Cornerstone Research report, in collaboration with the NYU Pollack Center for Law & Business. The mid-year number of actions for 2018 is also significantly below the average and median number of actions, 29 and 26, respectively, during mid-year FY 2010-2017. The number of cases naming individual defendants during this period also declined, while the size of monetary settlements decreased dramatically. For mid-FY 2018, the average monetary settlement was \$4.3 million, versus the next lowest, semi-annual average of \$13.3 million in mid-FY 2015.

This decline in enforcement activities suggests that Wall Street's top cop is less focused on rooting out corporate fraud and more focused on other regulatory matters seen as favorable to Wall Street and corporate America. This shift is unlikely to change with the changeover in SEC commissioners. For example, although Roisman testified before the Senate Banking Committee that he favors having “a strong enforcement program,” he defended the scaling back of subpoena power authority within the Enforcement Division, which occurred in early 2017. At that time, Piwowar revoked the subpoena authority for investigations given to senior enforcement officials by former SEC Chairwoman Mary Schapiro, and continued under her successor Mary Jo White, and instead placed subpoena authority in the hands of the director of enforcement, who the SEC chair appoints.

These changes do not bode well for investors. As Lynn Turner, former chief accountant for the SEC, warned when asked about the declining enforcement numbers for this piece: “History has taught us the lesson that during periods of lax law enforcement, the result is typically bad. Investors must be cognizant of this because the protection they otherwise expect from the SEC won't exist.”

In this environment of diminished SEC enforcement of the federal securities laws, the role of private actions against publicly held companies as a supplement to SEC enforcement becomes even more critical as a means to achieve accountability, recoup damages and effect positive corporate change.

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[1] <https://www.politico.com/newsletters/morning-money/2018/08/03/welcome-to-jobs-day-305606>

[2] <https://www.sec.gov/news/speech/jackson-shareholders-conversation-about-mandatory-arbitration-022618>

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