



# Year 3 of the SEC under President Trump

The Commission looks to grapple with a range of contentious corporate governance and financial disclosure issues

**Over the year ahead, the Securities and Exchange Commission is expected to face a full slate of challenges in the areas of corporate governance and financial disclosure, from the possible regulation of proxy advisory firms to studying a switch to biannual reporting.**

On November 14, six senators introduced a bill to address one of the most controversial issues in corporate governance: the regulation of proxy advisory firms. The bill would empower the SEC to conduct inspections of companies such as Institutional Shareholder Services and Glass Lewis, which critics argue have too much power over corporate proxy votes without offering sufficient transparency. The firms say such concerns are overblown.

The debate over regulating proxy advisory firms is the latest corporate governance and financial disclosure issue facing

the SEC as it enters its third year under the administration of President Donald Trump. The Commission is grappling in particular with challenges wrought by changes in technology and the evolution of investment trends.

Unlike some former presidents, Mr. Trump has taken a noticeable interest in SEC policy. In August, he asked the Commission to study switching corporate financial reporting to a biannual schedule in place of the current quarterly system. The president's favored means of communication—social media—is also a topic of concern for the SEC, as some

CEOs pioneer the use of new channels of communication with investors.

What are the views of market participants on these complex issues? And what are the best ways to address them? We spoke with four experts to find out.

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# Governance and disclosure

## The experts

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### Mergermarket

**The issue of regulating proxy advisory firms is hotly debated. Do you think such regulation is necessary? And what effect do you think it would have on the market?**

### Professor Charles Whitehead, Cornell Law School

I think there are three concerns that underlie current proposals to regulate proxy advisory firms. The first is simply a general uneasiness about any organization, particularly an unregulated organization, having the kind of influence these firms have. For many institutional shareholders, these firms' recommendations on how investors should vote are considered to be a best practice, and so a large portion of the institutional world relies upon what ISS or Glass Lewis or other proxy advisory firms tell them to do.

Secondly, there has historically been a concern, including testimony in prior Congressional hearings, that ISS and others have conflicts of interest or, at the very least, the appearance of conflicts of interest due to their dual roles of advising shareholders on how to vote and counseling companies on how to manage their shareholders. They are

paid by the same companies whose shareholders they're also advising. Even if there are internal firewalls separating the shareholder from the company divisions, at the very least, this looks like a conflict.

The third concern is with the process of correcting mistakes, or factual misunderstandings, in the recommendations the proxy advisory firms make. Proxy advisory firms work under a lot of time pressure, and there are peaks in the proxy season when they can become particularly busy. Not surprisingly, since people are people and sometimes make mistakes, a proxy advisory firm may not present the full picture when advising shareholders on how to vote, or they may simply be misinformed. The concern is that it's not always easy for a company to quickly correct those mistakes and it may not be entirely clear how to go about doing so.

So, on balance, I do think there is a strong argument for why proxy advisory firms should be regulated. What surprises me is that the firms have not gotten ahead of the curve and self-policed themselves. Most likely, what makes sense is for the SEC to exercise greater oversight over the proxy advisors, as well as (together with the Department of Labor) provide greater guidance regarding how investors should use the recommendations – something along the lines of, “Yes, you can look at what ISS or Glass Lewis says, but don't eat what they cook without understanding what's in the stew.”

**Bill Ide, The  
Conference Board  
Governance  
Center**

I I agree with Professor Whitehead that proxy advisory firms should be regulated. We've got a real problem, because market forces have created a system without there being any real

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**Charles Whitehead, Cornell Law School**

policy thought on the subject. All of a sudden, Glass Lewis and ISS have started influencing corporate decision-making without any public oversight and transparency. Their guidelines do not go through any public oversight process, but they can have a significant impact on the public interest. That is the area where SEC oversight is needed.

If these firms were only in the business of gathering facts and handing them over to investors, that would be fine. But that's not what they've done – they started there, but then began making recommendations, which in essence means they are impacting the vote. There has been some pressure on mutual funds not to delegate decision-making, but proxy advisors should be required to have SEC oversight of their practices. At the moment, there's no way of knowing what their process is in formulating voting recommendations. So that's the big need – for there to be SEC regulation requiring open disclosure and transparency from the firms.

The other issue is one also stated by Professor Whitehead, which is that ISS has a significant conflict of interest. They have their proxy advisory component, but then they also have a consulting component. And what do you do if you're



a company and ISS's consulting wing calls and says, "Hey, you're probably going to be dealing with ISS on their proxy vote recommendation – we can help you shape yourself." That's a complete conflict of interest. So those two entities need to be split.

I think the right method of regulation is for the SEC to just intervene. I don't think legislation is going to work, and it would give more flexibility to the SEC to mold remedies according to the facts.

**Scott Kimpel,  
Hunton Andrews  
Kurth**

I, too, am concerned that the proxy advisory firms wield a disproportionate influence over the proxy voting process. Virtually every other participant in this

process—brokers, banks, transfer agents, asset managers, even the public companies themselves—is subject to some level of regulatory oversight in this space, and it has always struck me as an anomaly that proxy advisory firms have for the most part escaped regulation. This is an area where I believe the SEC already has authority to regulate under the registration and antifraud provisions of the Investment Advisers Act, but for reasons not entirely clear to me, the agency has historically chosen not to do so. ISS has chosen to register as an investment adviser, but conducts its business in a way almost totally devoid of SEC oversight; Glass-Lewis is not registered or supervised at all.

I am intrigued by a recent bipartisan bill introduced in the Senate, the Corporate Governance Fairness Act. It is not as wide-ranging as some of the other bills that have made it through the House on the topic of proxy advisory firms, but I still believe the bill has some teeth. If enacted, the Act would require proxy advisory firms to register with the SEC and be subject to SEC oversight and inspection. A central feature of these examinations would be an assessment of the accuracy of the reports issued by proxy advisory firms, which is striking because one of the central critiques of the proxy advisory industry has been that the firms' reports may be inaccurate. Once the SEC staff is given a mandate to inspect, they usually do not make a half-hearted effort to do so.

Under the bill, the SEC would also be required to make periodic reports to Congress on the state of play in this industry. Inevitably, any deficiencies found in the inspections of proxy advisory firms would make their way into these reports

to Congress, perhaps building a record to support further legislative or regulatory reforms in the future if the record points in that direction.

**Mergermarket** **In August, President Trump contributed to the debate regarding the merits of quarterly vs biannual financial reporting. What benefits and drawbacks do you feel would accompany a switch to a biannual reporting period?**

**Lona Nallengara,  
Shearman &  
Sterling**

The underlying concern with quarterly reporting, coupled with quarterly guidance, is that it breeds a short-term perspective on managing a company — driving leaders of companies to manage to short-term results rather than long-term outcomes. The argument is that if the market is conditioned to receive an earnings release and a quarterly report every three months (along with an expectation to provide an outlook for what the next quarter's performance will be like), it is hard not to expect the leaders of a company (and everyone at the company) to want to make quarterly results as good as possible. Does quarterly reporting drive a leader of a company to make decisions so that the next quarter looks good, rather than making a harder decision to sacrifice short-term results for the longer term, sustained growth of her company?

Addressing short-termism is an important goal. It is in the best interest of long-term shareholders. Addressing it by eliminating quarterly reporting seems misguided and not addressing the root cause of the issue. Providing less information for investors as a means to incentivize companies to focus on long-term goals only hurts investors and will not likely

change practices. Boards working with management to focus on and articulating long-term strategic objectives and engaging with shareholders on the merits of the objectives and the plan to achieve those objectives would seem like a better approach.

**Scott Kimpel,  
Hunton Andrews  
Kurth**

This is an idea that may be embraced by smaller public companies where compliance costs are disproportionately high and financial analyst coverage is relatively low. But I suspect the institutional investor community will be so hostile to the idea that most mature public companies will continue reporting on a quarterly basis even if they have the option of doing so less frequently. Once companies provide information to investors, it is very difficult to pull back. And I believe there will also be peer pressure for seasoned issuers to continue providing disclosure on a quarterly basis. Even if a given company determines that there is some benefit to moving to a semi-annual schedule, if its chief competitor continues to report quarterly, competitive considerations will lead both companies to continue reporting quarterly.

**Bill Ide, The  
Conference Board  
Governance  
Center**

I think there's actually some confusion created here, because people often equate how often companies report financial information to how often they

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**Scott Kimpel, Hunton Andrews Kurth**

project earnings. They're two different things, and I don't think the key issue is quarterly financial reporting. I do think that projecting earnings is a real problem, because it puts pressure on boards and CEOs to think really short-term. The concern is that if you don't meet your projection, your stock price will drop. So there are companies that have moved away from quarterly earnings projections and I totally agree with that. I think we've got to start recognizing that today's stock price should not be the primary driver of boardroom decision-making – it should be the long-term interests of the company. So a five-year look is much healthier than a five-month look.

The key area where a corporate board ought to be held accountable is whether they have a coherent long-term strategy to create shareholder value. And if they don't, then that's a problem. That needs to be fully disclosed and that needs to be tracked. But if the company does the right thing, it should be allowed to have a hiccup or decide to increase G&A or R&D spending in ways that will benefit the five-year plan. The only people who really want the quarterly earnings are the sell-side analysts, because that's how they make their living.

**Professor Charles  
Whitehead,  
Cornell Law  
School**

I think semi-annual reporting is the wrong answer to the wrong problem. I agree with Bill – what the president is worried about has little to do with quarterly reporting. Instead, it has to do with quarterly earnings guidance, which is different. The problem with earnings guidance is that companies begin to manage toward what they have projected, and so potentially you end up with short-term managers who are looking simply to goose their numbers. That puts off the

ability to make long-term capital or other research investments.

But I think the question we should be asking is, if the world went to semi-annual reporting, would you no longer have quarterly earnings guidance? Would it become semi-annual earnings guidance instead? There's nothing that suggests the world would change in this way. And that's because we still think about companies being managed on a quarterly basis. As long as the market continues to make quarterly assessments about companies, whether the company is formally required to disclose semi-annually or quarterly is going to be less relevant.

We weren't always on a quarterly system – some decades ago, we were on a semi-annual and an annual system. And there is some historical support for the notion that greater information in the marketplace, as we moved to quarterly reporting, made the market more efficient and increased value for shareholders. None of that should be a surprise. If investors have more information, and are more comfortable with the value they can assign to investments, then perhaps you will see an increase in the value of what's in the market. Conversely, lowering that level of information may cause a drop in value – and so we need to be careful about efforts that may not address the real culprit, quarterly earnings projections, but lower the company information on which the market relies.



# Social media and the year ahead

## The experts

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### Mergermarket

**Elon Musk recently reached a settlement with the SEC over his Twitter comments about taking Tesla private. Do you expect disclosure issues on social media to become more frequent in the coming months and years? What safeguards should companies put in place to prevent such problems?**

### Professor Charles Whitehead, Cornell Law School

Creative, aggressive, and maybe even obstinate CEOs are not new. It's the nature of a CEO that you're going to be a little bit headstrong and, in most cases, that you're going to be focused on getting your views out there. Elon Musk seems to fit that model.

But a seasoned CEO understands that she's got to temper that sort of drive with an understanding of the regulations, and more importantly, an understanding that what you're saying publicly may have real repercussions. We've seen CEOs who have said things in speeches that they shouldn't have said, or said things to reporters that they shouldn't have said, or issued press releases that they shouldn't have issued. And what happens? The exact same thing that happened to Elon

Musk. The difference is that he did it through Twitter.

The critical difference today is that it's easier to convey information directly to the marketplace because of new technology. But the basic problem, which is that headstrong CEOs sometimes do things they shouldn't do, and communicate information they shouldn't communicate, has been around for decades. This raises a concern, since we are in a phase where a lot of startups, with new CEOs, are accessing the capital markets, and these CEOs are often less tempered than the CEOs of companies that have been around for 100 years. The fact that you can get information out quickly through tools such as Facebook and Twitter has the potential to become a real issue, because now the CEO can go directly to the market without having information vetted through investor relations, press officers, and lawyers. What that means is that a CEO should

be told, "Before you tweet something, show it to somebody" – just like before you issue a press release you would vet it with the right people.

**Lona Nallengara,  
Shearman &  
Sterling**

The method that companies communicate with shareholders, customers and the market is changing. Years ago, a newspaper ad or a press release was the primary form of communication. Today, often, the time it takes to draft and post a press release may be too long to react to a fast-moving story or an event at your company. I think the SEC recognizes that. The SEC recognizes that investors and the markets consume information from a variety of sources and the SEC does not want to weigh in on what methods of communication are the best ones or decide which ones work or not. The SEC simply wants to make sure that investors have access to the communication methods used and that investors know that a company will be using an identified



yes, companies will continue to use different forms of communication, and increasingly these will include social media. It started with websites and then company Facebook pages and Twitter posts. As companies seek to be more connected with customers and investors, communicating using the same, common technology will be important.

As more and more companies seek to use social media, they are also increasingly seeking to give their CEO a presence on social media. It is important for companies to look at all social media, including the personal posts of a CEO or other executives, in the same way as they would look at any communication by the company. Social media posts, including personal executive posts, should be subject to the same rigor as any other communication of the company. Before any communication, social media or otherwise, companies should be asking: Is the information we are communicating material to our business? Are the appropriate individuals in the company aware of this communication? Have we said it anywhere else before? Does this communication trigger any specific disclosure requirement? Are there any reputational issues with the form, content or timing of this communication? And, most importantly, is the content of the communication true? These questions are relatively standard to consider in connection with preparing and issuing a press release, but it can be more challenging as a CEO tries to post a 280-character message on Twitter. Nonetheless, it is important to bring a comparable set of disclosure controls and procedures to a social media post, even ones by a CEO in her personal capacity. A CEO speaking will be viewed as speaking for the company and a post from the CEO can have immediate and significant

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**Scott Kimpel, Hunton Andrews Kurth**

impact on the stock price and market perception of the company. Companies can get into trouble with the SEC if they have not designed disclosure controls to contemplate social media posts.

**Scott Kimpel,  
Hunton Andrews  
Kurth**

What's really interesting to me is the disruptive effect of social media on the SEC's rules governing disclosure of information to investors. The SEC continues to exert tight control over companies' ability to distribute information, principally through the enforcement of so-called Regulation "Fair Disclosure," which most people shorthand to Regulation FD. My personal view is that Regulation FD may run afoul of the First Amendment insofar as it prohibits otherwise truthful speech, particularly in light of the Supreme Court's jurisprudence concerning corporate speech over the past several years. But an even bigger problem with Regulation FD is that it was adopted in 2000, many years before the emergence of the 24-7 news cycle, the advent of social media or the widespread availability of smartphones. The SEC did not (and probably could not) contemplate these technological developments.

Investors today would prefer to have instantaneous access to information, and

don't necessarily want to wait for the next earnings call or 10-Q filing to get it. They also want the information in a format they are accustomed to, and for most retail investors that does not entail going to the SEC's byzantine website or even the investor relations tab of their favorite public company. It means having the information ready to go in social media. And the SEC procedure for companies to disclose investor information through that channel is clunky at best. I share some ideas for modernizing this process with your next question, and hope that the SEC will revisit this area sooner rather than later.

**Mergermarket** **Which areas of corporate governance and financial disclosure do you think deserve the SEC's attention in the year ahead? Which areas do you expect the Commission to focus on?**

**Scott Kimpel,  
Hunton Andrews  
Kurth**

I think the entire manner in which we communicate with investors is something that should be looked at. I'll credit the former SEC Chairman Mary Jo White with starting the disclosure effectiveness project, which was meant to be a top-to-bottom review of the regulatory reporting process for public companies. They looked at both the legal disclosure requirements and the accounting disclosure requirements and there was a lot of fanfare around it. There were some great staff reports written about the history of disclosure, but the actual changes that came out were much more focused.

After several years of proposal and comment, the Commission not too long ago adopted the first round of changes with something called the Disclosure Simplification Release. It was really something of interest only to technical lawyers and accountants, not a fundamental rethinking of the disclosure system.

The format for delivery of information is something that could be looked at. It could become a kind of live electronic database, rather than these static reports that often don't change much over time. I think doing something like that would be fascinating. Another area to consider would be broadening the use of new distribution channels, since people now get their information off their smartphones and through social media feeds in today's world of the 24/7 news cycle.

I also think the entire proxy plumbing area is one that the Commission should take up. I'm active in the blockchain world, and there are technological solutions to at least some of the proxy plumbing issues. They involve deploying distributed ledgers to replace the shareholder ledger system that we currently have – that could get us back to a place where you have instantaneous communications between buyers and sellers, as well as instantaneous clearance and settlement, which is not something we have now.

What would also be interesting and appropriate is to accommodate the trading of digital securities. Overstock.com has a blockchain preferred stock that they issued a few years ago, but a lot of the clearance and settlement of that is still done through conventional means, because the existing regulations don't provide the full range of flexibility that I think is necessary to permit direct communication between buyers and sellers, and the direct recording of transactions on distributed ledgers. That's another area I think the SEC should look at.

**Lona Nallengara,  
Shearman &  
Sterling**

Corporate governance is not entirely within the scope of the SEC's mandate, so there is a real challenge to identify what would be appropriate for the SEC

to address through changes in disclosure or other requirements. By and large, the Commission has approached these corporate governance questions by creating disclosure requirements, such as disclosure of a company’s policy on diversity, rather than a mandating a particular action.

Key issues in corporate governance right now include board diversity, board oversight over environmental matters, broader social policy issues, and cybersecurity and data privacy questions. Changes in the specific disclosure requirements in these areas could come, but what is more likely, and what we have seen with so many governance issues over the last number of years, is that private ordering will be the strongest catalyst for change. Institutional investors and other advocates will put pressure on companies to address the issues that are important to them – topics like board diversity issues, pay equity and cybersecurity and data privacy. So, like we saw with the broad adoption of proxy access through advocacy and private ordering, a rule change from the SEC will not be the biggest driver of governance changes for public companies – the advocacy of shareholders will.

**Bill Ide, The  
Conference Board  
Governance  
Center:**

A critical area I see for SEC continued focus is getting the public markets back to fulfilling their mission of job creation and GDP growth. The fact that public markets are shrinking is a major concern.

Long-termism is clearly the key issue – moving the public markets away from speculation and toward a place where markets are all about value creation is critical. It is imperative that boards and long-term investors align on requiring and

then supporting a company’s long-term strategy. The Common Sense Principles recently signed by CEOs of major public companies and index fund CEOs provides the needed road map for long-termism. Now, the index funds and the big pension funds must “walk the talk.” While they are saying the right things for long-termism, they also have investments in activist hedge funds, and you can’t have it both ways. Hopefully the Common Sense Principles will provide the forward guidance to assure the restoration of the public markets to their critical role in creating prosperity for our economy.



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