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Corporate Governance Update: Thank You, Chairman Clayton

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Under Chairman Jay Clayton, who concluded his tenure at the Securities and Exchange Commission in late December, the SEC experienced an era of great productivity and rational reform. He furthered the historic mission of the SEC while maintaining nonpartisan credibility and independence in a highly charged political environment. Chairman Clayton affirmed the Commission's tripartite purpose—to protect investors, to maintain fair, orderly, and efficient markets, and to facilitate capital formation—throughout his time in office, rightly emphasizing in public statements that these three elements should be viewed as correlated rather than as contradictory.

During his tenure, Chairman Clayton spoke frequently of the Commission's role in "looking out for" the long-term interests of the 52% of American households who participate in the capital markets. Reforms such as Regulation Best Interest and the amendments to the rules relating to proxy advisory firms increased protections for retail investors and improved the quality of their institutional relationships by requiring better disclosure, fewer conflicts of interest, and heightened fiduciary obligations. In the coming years, Main Street investors will reap the benefits of not only the heightened protections, but also the expanded market opportunities, that will result from SEC initiatives taken under Chairman Clayton's leadership.

Multidimensional Investor Protection

Chairman Clayton stated from the outset that rulemaking during his tenure would be designed to maximize the long-term interests of the retail shareholder. The regulatory initiatives undertaken by the SEC under his direction were generally clear and orderly, in part due to the streamlining of the Commission's public agenda under the Regulatory Flexibility Act. The SEC's Reg Flex Agenda set the tone for transparency and efficiency by heightening public accountability and providing an operational roadmap for near-term regulatory action. Several reforms stand out in particular for their welcome effects.

One long-awaited and well-taken initiative was the adoption of amendments to the proxy rules regarding the role of proxy advisory firms. Institutional voting has been disproportionately influenced by proxy advisors, a concern of particular

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importance now that individuals are investing at unprecedented levels through institutional holdings. In 2019, the SEC issued guidance clarifying that investment advisers who vote proxies are required to act in their clients' best interests by carefully overseeing the work of any proxy advisory firms they engage. Under the July 2020 amendments to the proxy rules, proxy advisory firms may rely on the exemptions from the solicitation rules only if they disclose their conflicts of interest, provide companies with a timely copy of their proxy advice, and provide their clients with a means of obtaining any response from subject companies regarding the advice provided. The end result is that the interests of individual investors will be better protected by the fiduciary obligations of those who exercise the shareholder franchise on their behalf. The new amendments, over a decade in the making, were adopted after a robust comment process and will be effective in December 2021. Together, the 2019 guidance and 2020 amendments represent an important step toward curbing the undue influence of proxy advisors in director elections.

Investor protection also received a boost from the new Regulation Best Interest, adopted and effective in 2019, which for the first time establishes an enhanced standard of conduct for broker-dealers. The rule requires broker-dealers to act in the best interests of their retail customers, without placing their own interests ahead of those of their customer. It also raises the level of transparency in the relationship between individual investors and financial professionals by requiring broker-dealers to disclose, mitigate, or eliminate conflicts of interest. Regulation Best Interest incorporates certain elements of the fiduciary obligations applicable to investment advisers under the Investment Advisers Act of 1940 (obligations that the SEC took the opportunity to reaffirm and clarify), with the effect that investors now are entitled to unconflicted counsel from both broker-dealers and investment advisers. At the same time, investors continue to have the flexibility to choose different types of professional investment services and to engage in a range of compensation structures for these services. The new rules are practical and realistic in that they accommodate investor preferences while requiring market professionals to adhere to fiduciary principles.

Under Chairman Clayton, the Commission took a multifaceted approach to investor protection, with the view that: "Encouraging capital formation in our public markets has the benefit of providing a broader and more attractive set of investment opportunities to Main Street investors, who benefit from public company stock prices that reflect not only publicly reported information but also the views of professional investors." To this end, rules adopted in November 2020 streamline the capital-raising process for small- and medium-sized businesses and facilitate growth by implementing, among other things, an integration framework for private offerings. As Commissioner Hester Peirce stated at the time of the proposing release: "Investor protection is not unidimensional…. Investor protection also means allowing investors of all income levels to participate in a wide range of offerings that allows them to build balanced and diversified portfolios. The proposal today demonstrates a recognition of some of these often-overlooked tenets of investor protection." Removing excessive burdens on small businesses and unnecessary friction in the transition from private to public markets increases opportunities for companies and investors and benefits the economy as a whole. This robust view of investor protection serves all market participants.

An internal effort that stands as emblematic of Chairman Clayton's legacy is the new diversity and inclusion initiative at the Commission. Last year, the SEC released its first Diversity and Inclusion Strategic Plan, a program designed not only to increase opportunities for diverse candidates within the Commission's workforce but also to integrate the tenets of diversity, inclusion, and opportunity into the SEC's work more broadly by promoting these principles in the capital markets. The results were significant progress within the SEC toward fairness and inclusion, and broader access to capital, better information, and stronger safeguards for individual investors in the markets.

The Role of a Regulator

The SEC at its best is a highly effective government institution whose far-reaching actions touch, in one way or another, every participant in the capital markets. In a speech at the Economic Club of New York in November 2020, Chairman Clayton observed: "Our mission … serves as the greatest source of our authority, expertise and, ultimately, our independence. The further we stray from it, the weaker each of those becomes." Chairman Clayton showed rare integrity and constancy of purpose in resisting external pressures to pursue political objectives. As a result, the initiatives promulgated during his tenure transcend the politics of the day.

The arrival of the COVID-19 pandemic disrupted every facet of life in the United States. Nonetheless, the resilience and orderly operation of the capital markets during a year of unprecedented stress and uncertainty has been a major factor in positioning the U.S. economy for recovery. Chairman Clayton ensured that the SEC worked to maintain market stability and assist issuers in their efforts to continue operations and obtain needed funding. Operating in difficult circumstances, Chairman Clayton deserves great credit for his steady leadership, for his fidelity to the Commission's enduring mission, and for his role in improving the quality and availability of investment opportunities for every market participant.