Securities Practice Update

Paul | Weiss

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Facilitating Access to the Capital Markets

SEC Extends the "Test-the-Waters" Accommodation to All Issuers

In September 2019, the SEC adopted a new rule (available here) under the Securities Act of 1933 extending a "test-the-waters" accommodation, previously available only to emerging growth companies ("EGCs"), to all issuers.

Under new Rule 163B, all issuers will be allowed to gauge market interest in an initial public offering or other registered securities offering through oral or written communications with certain institutional investors prior to, or following, the filing of a registration statement (see our client alert here).

SEC Publishes Concept Release on Ways to Harmonize Private Securities Offering Exemptions

In June 2019, the SEC published a concept release (available here) seeking comment on ways to simplify, harmonize and improve the exempt offering framework. The concept release requested public comment on certain general questions.

- *The Exempt Offering Framework*. Is the SEC's exempt offering framework, as a whole, consistent, accessible and effective for both companies and investors? What changes should the SEC consider to simplify, improve and harmonize the exempt offering framework?
- *The Capital Raising Exemptions within the Framework*. Should there be any changes to improve, harmonize or streamline any of the capital raising exemptions, specifically: the private placement exemption and Rule 506 of Regulation D, Regulation A, Rule 504 of Regulation D, the intrastate offering exemptions and Regulation Crowdfunding?
- *Potential Gaps in the Framework*. Are there gaps in the SEC's framework that may make it difficult, especially for smaller companies, to rely on an exemption from registration to raise capital at key stages of their business cycle?

SEC Approves Nasdaq Rule Change to Facilitate Listing Without an Initial Public Offering

In February 2019, the SEC approved a Nasdaq rule (available here) designed to facilitate a direct listing of a company's shares without conducting an initial public offering. The new Nasdaq rule is substantially similar to the direct listing rule adopted by the New York Stock Exchange ("NYSE") in February 2018 and is aimed at facilitating direct listings by the growing number of highly valued start-ups, including so-called "unicorns," that have tended to delay going public in part because they have sufficient capital and therefore have no need to raise additional capital by undertaking a traditional underwritten primary offering of their shares. In April 2018, Spotify Technology took advantage of the NYSE rule change to undertake a direct listing on the NYSE (see our client alert here).

Disclosure Effectiveness Initiatives

SEC Proposes to Streamline Descriptions of Business and Legal Proceedings, and Risk Factor Disclosures, Under Regulation S-K

In August 2019, the SEC proposed amendments (available here) to Regulation S-K that aim to streamline the descriptions of business and legal proceedings, and risk factor disclosure requirements. The proposed changes would, among other things:

- *Shift the disclosure framework to a more principles-based approach*. The proposed amendments would require a registrant to focus on material information in its business description. The amended Items 101(a) and 101(c) of Regulation S-K would provide suggested topics for identifying material information, but registrants would not have to address specific items unless material to their business.

- *Permit the use of hyperlinks in business description*. For filings made after a registrant's initial registration statement, the proposed amendments would only require the registrant to provide an update on its general business development under Item 101(a) for any material developments in the reporting period. A registrant would include a hyperlink to the most recent filing that, together with the update, would contain the full discussion of the general development of the registrant's business.

- *Reduce length of risk factor disclosure*. The proposed amendments would require registrants to provide summary risk factor disclosure if their risk factor section exceeds 15 pages. The proposed amendments would also heighten the standard for including risk factors. Registrants would only need to identify "material" risks (as opposed to the "most significant" risks under the current rule). Generic risk factors applicable to other companies or offerings would be placed at the end of the risk factor section under the caption "General Risk Factors" (see our client alert here).

SEC Proposes to Amend Definitions of "Accelerated Filer" and "Large Accelerated Filer"

In May 2019, the SEC announced a proposal (available here) to amend the definitions of "accelerated filer" and "large accelerated filer" under Rule 12b-2 of the Exchange Act, in an ongoing effort to reduce costs and reporting requirements for registrants. The proposed rule changes would:

- exclude from "accelerated filer" and "large accelerated filer" status a registrant that is eligible to be treated as a "smaller reporting company" and that had annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available;

- increase the transition thresholds for accelerated and large accelerated filers becoming non-accelerated filers from $50 million to $60 million and for exiting large accelerated filer status from $500 million to $560 million; and

- add a revenue test to the transition thresholds for exiting both accelerated and large accelerated filer status.

As a result of the proposed rule changes, certain low-revenue registrants would not be required to have their assessment of the effectiveness of internal control over financial reporting ("ICFR") attested to, and reported on, by an independent auditor, although they would continue to be required to make such assessments and to establish and maintain the effectiveness of their ICFR (see our client alert here).

SEC Proposes to Streamline Disclosures Relating to Acquisitions and Dispositions

In May 2019, the SEC proposed rule changes (available here) to streamline the information that investors receive in connection with significant acquisitions and dispositions. The proposed changes would, among other things:

- *Update the significance tests when evaluating what financial statements are required.* The SEC proposes to revise the investment and income tests under Rule 3-05 of Regulation S-K in part to reduce the anomalous results that can occur in the application of the definition of "significant subsidiary." The investment test compares the company's investment in the acquired business to the carrying value of the company's total assets. The SEC proposes to revise the investment test to compare the company's investment in the acquired business to the aggregate worldwide market value of the company's voting and non-voting common equity. The income test compares the company's equity in the pre-tax income from the continuing operations of the acquired business, excluding any amount attributable to non-controlling interests, to the same measure of the company. The SEC proposes to revise the income test by adding a new revenue component and simplifying the calculation of the net income component by using income or loss from continuing operations after income taxes.

- *Limit the financial statement requirement to a maximum of two years*. The SEC proposes eliminating the requirement to file the third year of Rule 3-05 financial statements for an acquisition that exceeds 50% significance.

- *Permit abbreviated financial statements in certain circumstances*. The SEC proposes to permit registrants to provide abbreviated financial statements regarding assets acquired and liabilities assumed if certain conditions are met.

- *No longer require separate acquired business financial statements after one year*. The SEC proposes to no longer require acquired business financial statements once the acquired business is reflected in filed post-acquisition registrant financial statements for a complete fiscal year.

- *Revise significance threshold for the disposition of a business*. The proposed rules also revise Rule 11-01(b) to raise the significance threshold for the disposition of a business from 10% to 20% to conform it to the threshold at which an acquired business is significant under Rule 3-05; and to conform, to the extent applicable, the tests used to determine the significance of a disposed business to those used to determine the significance of an acquired business (see our client alert here).

SEC Adopts Rules Modifying and Simplifying Regulation S-K

In March 2019, the SEC adopted amendments (available here) to Regulation S-K and related rules and forms to modernize and simplify disclosure requirements for public companies, investment advisers and investment companies (see our client alert here). The amendments include the following:

- *Revisions to MD&A Disclosure Requirements*. The period-to-period comparisons required in the MD&A by Item 303(a) of Regulation S-K are limited to the two most recent fiscal years covered by the financial statements, rather than the existing three-year requirement, so long as the discussion of the earliest of the three years has been included in the registrant's prior filings on EDGAR. A narrative discussion could also be used in lieu of the year-to-year comparisons as currently required if the registrant believes the narrative discussion is a more appropriate way of conveying the information.

- *Streamlining of Confidential Treatment Provisions*. The amendments allow registrants to omit confidential information from material contracts filed under Item 601(b)(10) (Material Contracts) where such information is both (i) not material and (ii) would likely cause competitive harm if publicly disclosed, even where the registrant has not submitted a confidential treatment request as is currently required.

- *Limitation on Material Contracts Required to Be Filed*. Previously, registrants were required to file material contracts not made in the ordinary course of business if one of two tests is met: (i) the contract is to be performed in whole or in part at or after the filing of the registration statement or report or (ii) the contract was entered into within the last two years before the filing. The second test—the two-year look-back—captures material contracts that were performed before the filing date. The amendments eliminate the two-year look-back test for all registrants other than newly reporting registrants.

- *Disclosure of Executive Officers*. The amendments clarify that any disclosure about executive officers required by Item 401 of Regulation S-K will not need to be duplicated in the registrant's proxy statement if the information is already included in the registrant's Form 10-K.

- *Required Hyperlinks*. The SEC has implemented new rules requiring registrants to include hyperlinks to exhibits in exhibit indexes.

Annual Reporting Season Preview

New Audit Standard Requiring Disclosure of Critical Audit Matters

For calendar year Large Accelerated Filers, the 2019 annual report will be the first to include disclosure of critical audit matters ("CAMs") in the auditor's report. In 2017, the Public Company Accounting Oversight Board (the "PCAOB") adopted a new audit standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (available here), requiring auditors to include in their reports a discussion of CAMs—namely, matters that (i) have been (or are required to be) communicated to the audit committee, (ii) are related to accounts or disclosures that are material to the financial statements and (iii) involved especially challenging, subjective or complex auditor judgment. Once a CAM is identified, the auditor's report must (i) identify the CAM, (ii) describe the principal considerations that led the auditor to determine that the matter was a CAM, (iii) describe how the CAM was addressed in the audit and (iv) reference the relevant financial statement accounts or disclosures. Large Accelerated Filers must fully comply with AS 3101 for fiscal years ending on or after June 30, 2019 (other companies subject to AS 3101 must fully comply for fiscal years ending on or after December 15, 2020) (see our client alert here).

SEC Issues Guidance on Proxy Voting Responsibilities of Investment Advisers and the Applicability of Proxy Rules to Proxy Voting Advice

In August 2019, the SEC approved much anticipated guidance (available here) regarding the applicability of proxy rules to proxy voting advice and related guidance regarding proxy voting responsibilities of investment advisers. The guidance takes a middle-of-the-road approach between the more stringent regulation that registrants had sought and maintaining the status quo as proxy advisory firms and some investors had urged.

- *Guidance Regarding the Applicability of Rules Promulgated under Section 14 of the Exchange Act to Proxy Voting Advice*. The SEC affirmed that (i) proxy voting advice generally constitutes a solicitation under the U.S. proxy rules; and (ii) Rule 14a-9's antifraud provisions apply to proxy voting advice.

- *Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*. The SEC affirmed the following:

  (i) An investment adviser that has assumed voting authority should take steps to conduct a reasonable investigation to determine that its voting decisions are in a client's best interests and in compliance with its policies and procedures.

  (ii) In retaining a proxy advisory firm, an investment adviser should consider whether the firm has the capacity and competency to adequately analyze the matters for which the investment adviser is responsible for voting.

  (iii) The investment adviser's policies and procedures should be reasonably designed to ensure that its voting determinations are not based on materially inaccurate or incomplete information.

  (iv) An investment adviser should adopt policies and procedures to evaluate the proxy advisory firm's services and to update such evaluations on a periodic basis (see our client alert here).

SEC Adopts Final Rules for Disclosure of Hedging Policies

After several years of consideration, the SEC has adopted final rules (available here) to require disclosure of hedging practices or policies in proxy and information statements relating to the election of directors. The final rules add new Item 407(i) to Regulation S-K to require a registrant to describe any practices or policies it has adopted regarding the ability of its employees (including officers) or directors, or any of their designees, to purchase securities or other financial instruments, or otherwise engage in transactions, that hedge or offset, or are designed to hedge or offset, any decrease in the market value of equity securities granted as compensation, or held directly or indirectly by the employee or director.

Domestic registrants must comply with the new requirements for fiscal years beginning on or after July 1, 2019 – which, for calendar year-end companies, means that compliance will begin in 2020. Smaller reporting companies and emerging growth companies have an additional year to comply (see our client alert here).

SEC Announcement on Shareholder Proposal No-Action Letter Process

In September 2019, the SEC announced (available here) that its staff may respond orally, instead of in writing, to no-action requests for shareholder proposals under Rule 14a-8 of the Exchange Act. The SEC will only issue a written response where it believes doing so would provide value, such as broadly applicable guidance about complying with Rule 14a-8. If the SEC declines to state a view on a shareholder proposal, the interested parties should not interpret that position as indicating that the shareholder proposal must be included in the company's proxy materials. In such circumstances, the SEC is not taking a position on the merits and the company may have a valid basis for excluding the proposal.

SEC Proposes Amendments to Improve Accuracy and Transparency of Proxy Voting Advice and Modernize Shareholder Proposal Rules

In November 2019, the SEC proposed amendments (available here) to its proxy solicitation rules as applicable to proxy voting advice and its Rule 14a-8 shareholder proposal procedures. The proposed amendments would codify the SEC's interpretation that proxy voting advice constitutes a solicitation under the Exchange Act. Nevertheless, proxy advisory firms would be exempt from the information and filing requirements of the proxy rules if they (i) do not seek to act as a proxy for shareholders; (ii) disclose material conflicts of interest in their proxy voting advice; (iii) provide companies with an opportunity to review and provide feedback on the proxy voting advice before distributed; and (iv) include a hyperlink in the proxy voting advice to the company's proxy position if so requested by the company.

The proposed amendments would also modify the eligibility requirements for shareholders to submit proposals for inclusion in a proxy statement. A shareholder under the current rule must hold $2,000 or 1% of company stock for one year to submit a proposal. The proposed amendments would permit a shareholder to submit a proposal if holding (a) $2,000 of company stock for three years; (b) $15,000 of company stock for two years; or (c) $25,000 of company stock for one year (see our client alert here).

Other Updates

SEC Adopts New Standard of Conduct for Broker-Dealers

In June 2019, the SEC adopted a package of rulemakings and interpretations (available here) addressing investors' relationships with broker-dealers and investment advisers. Under the new Regulation Best Interest (Exchange Act Rule 15l-1), a broker-dealer will be required, when making a recommendation regarding any securities transaction or investment strategy, to act in the best interest of a retail customer without placing their respective financial interests ahead of the customer. All broker-dealers must comply with the new rule beginning June 30, 2020.

A broker-dealer will satisfy its "best interest" obligation by complying with four component obligations.

- *The Disclosure Obligation.* Prior to or at the time of any recommendation, a broker-dealer must provide a retail customer, in writing, full and fair disclosure of all material facts relating to (a) the scope and terms of the relationship with the retail customer and (b) conflicts of interest that are associated with the recommendation.
- *The Care Obligation.* A broker-dealer must exercise reasonable diligence, care and skill when making a recommendation to a customer.
- *The Conflict of Interest Obligation.* A broker-dealer must establish, maintain and enforce written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate, all conflicts of interest associated with its recommendations.
- *The Compliance Obligation.* A broker-dealer must establish, maintain and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest (see our client alert here).

SEC Issues Statement Highlighting Risks Regarding LIBOR Transition

In July 2019, the SEC staff issued a statement (available here) urging market participants to prepare for the transition away from the LIBOR reference rate. This announcement echoed those made by other regulators that the transition from LIBOR to alternative reference rates must be a focus well before LIBOR ceases publication, which is expected to occur in 2021. The LIBOR statement encourages market participants to: commence the process of identifying contracts that extend beyond 2021 to determine their exposure to LIBOR; consider, when entering into new contracts that would normally reference LIBOR, whether to instead reference an alternative reference rate such as the Secured Overnight Financing Rate, or if the decision is made to reference LIBOR, whether to include effective fallback language to account for the cessation of LIBOR's publication; and assess the impacts, if any, that the discontinuation of LIBOR will have on existing and new contracts, and to implement mitigation efforts accordingly (see our client alert here).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Mark S. Bergman
+44-20-7367-1601
mbergman@paulweiss.com

Andrew J. Foley
+1-212-373-3078
afoley@paulweiss.com

David S. Huntington
+1-212-373-3124
dhuntington@paulweiss.com

Associate Michael N. Bendetson also contributed to this Securities Practice Update.