Securities Practice Update

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SEC Updates

The new year brings with it a new administration as well as new senior leadership at the SEC.

Chairman Jay Clayton will conclude his tenure at the end of the year. William H. Hinman, Director of the SEC's Division of Corporation Finance, left the SEC at the end of November.

In addition, Brett Redfearn, Director of the SEC's Division of Trading and Markets, Stephanie Avakian, Director of the Division of Enforcement, and Robert B. Stebbins, General Counsel, will all leave the SEC by the end of 2020. S.P. Kothari, Chief Economist and Director of the SEC's Division of Economic and Risk Analysis, will leave the SEC by the end of January. Raquel Fox, Director of the Office of International Affairs, left the SEC in November.

Those responsible for rulemaking at the Division of Corporation Finance were very busy. This update covers nine final rule releases, and three proposed rule releases issued by the SEC since August 1, 2020 (in addition to several exchange proposals and annual meeting matters). These efforts followed an unprecedented number of public statements and temporary relief for reporting companies in response to the pandemic during the first half of the year.

Disclosure Effectiveness Initiatives – S-K Amendments

As part of the SEC's modernization initiatives, the SEC adopted a number of changes to Regulation S-K in the latter half of 2020.

In November, the SEC adopted amendments (available here) to the financial disclosure requirements of Regulation S-K, including the requirements governing the presentation of Management's Discussion and Analysis (see our client memo here). *These changes are not yet effective* – they will become effective 30 days after publication in the *Federal Register* (which has not yet occurred), and be required for fiscal years ending on or after the date that is 210 days after the publication of the amendments. Early compliance will be permitted as of the effective date, so long as any amended item (*e.g.*, all of Item 303) is complied with in its entirety.

Previously, in August, the SEC adopted amendments (available here) to Regulation S-K that update disclosure requirements regarding the Description of the Business (Items 101(a) and 101(c)), Legal Proceedings (Item 103) and Risk

Factors (Item 105) (see our client memo here). *These amendments took effect on November 9, 2020.*

MD&A and Other Financial Disclosure Requirements

Key highlights of MD&A changes:

- *Objective*: This is a new introductory section to MD&A, and is intended to help companies focus on the key purpose of MD&A and on "material" and "reasonably likely" impacts.

- *Liquidity and Capital Resources*: These disclosure items have been combined and updated to require disclosure of "material cash requirements."

- *Critical Accounting Estimates*: The amendments codify and enhance prior SEC guidance to require the disclosure and discussion of critical accounting estimates.

- *Off-Balance Sheet Arrangements and Tabular Disclosure of Contractual Obligations*: As part of the effort to reduce duplicative disclosure, current Items 303(a)(4) (off-balance sheet arrangements) and 303(a)(5) (tabular disclosure of contractual obligations), both introduced in 2003 as part of the Sarbanes-Oxley reforms, have been eliminated.

- *Interim Period Disclosures*: The amendments give companies the flexibility to compare quarterly results to the prior year's quarter or the immediately preceding quarter.

In addition, the amendments eliminate the requirement to present five years of selected financial data (Item 301); and simplify and streamline the presentation of supplementary financial data (Item 302). Companies will no longer be required to provide two years of tabular supplementary quarterly financial information.

Foreign Issuers

The amendments make several conforming changes to Form 20-F and Form 40-F to ensure that the existing MD&A requirements for foreign private issuers mirror the substantive MD&A requirements set forth in revised Item 303 and the elimination of Item 301 of Regulation S-K (see our separate client memo here).

Business, Legal Proceedings and Risk Factors

Key highlights of the other Regulation S-K changes include:

Item 101 – Business

- the prescriptive list of topics was replaced with a non-exclusive list of the types of information that may need to be disclosed to the extent material to an understanding of the business;

- the five-year disclosure requirement regarding development of business was eliminated – instead companies must disclose "information material to an understanding of the development of the business;"

- companies may now provide just an update of their general business development since the most recent consolidated discussion thereof contained in a previously filed registration statement or report, with an active hyperlink to such discussion (which must be contained in a single document), which incorporates such disclosure by reference; and

- new disclosure items:

  - *Human Capital Management* (Item 101(c)) – requires companies to disclose, with respect to, and to the extent material to an understanding of, the business taken as a whole (or, if material to a particular segment), "A description of the registrant's human capital resources, including the number of persons employed by the registrant, and any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel);" and

  - *Material Updates to Business Strategy* (Item 101(a)) – companies must now disclose any material changes to any previously disclosed business strategy (note, there is no underlying requirement to disclose business strategy).

Item 103 – Legal Proceedings

- amendments permit companies to provide some or all of the required information by cross-referencing disclosure found elsewhere in the report or filing;

- the threshold for disclosure of environmental proceedings that involves potential monetary sanctions has increased to $300,000 from $100,000, or to such other threshold as determined by the company that will result in disclosure if the proceeding is material (company must disclose such other threshold); and

- any such proceeding where potential sanctions exceed the lesser of $1 million or 1% of assets needs to be disclosed.

Item 105 – Risk Factors

- if the risk factor section exceeds 15 pages, companies must include a two-page summary (the summary need not include all risk factors);

- the risk disclosure standard has changed from "most significant" to "material;"

- companies must organize risk factors under relevant headings; and

- companies must move risk factors that apply generally to other companies or offerings to the end of the section under the heading "General Risk Factors."

Foreign Issuers

Since Regulation S-K does not apply to foreign private issuers unless a form reserved for foreign private issuers (*e.g.*, Form F-1, F-3 or F-4) specifically refers to Regulation S-K, the amendments to Items 101 and 103 apply only to domestic companies and foreign private issuers that have elected to file on domestic forms. The amendments to Item 105 apply to both domestic and foreign private issuers.

Facilitating Access to Capital Markets

Expansion of "Accredited Investor" and "Qualified Institutional Buyer" Definitions

In August, the SEC adopted amendments (available here) to the definitions of "accredited investor" ("AI") and "qualified institutional buyer" ("QIB") to include new AI categories of natural persons and entities and an expanded list of eligible entities that qualify as QIBs. The amendments to the AI and QIB definitions, although modest in scope, are a welcome step towards the modernization of the two concepts that play a key role in determining investors' eligibility to participate in private securities offerings. The definitions had previously remained largely unchanged for over 35 years. *The amendments became effective December 8, 2020* (see our client memo here).

Harmonization Release

In November, the SEC adopted amendments (available here) to modernize, harmonize and simplify the exempt offering framework (see our client memo here). *These changes are not yet effective*; they will become effective 60 days after their publication in the *Federal Register* (which has not yet occurred). As part of these amendments, the SEC:

- overhauled its integration framework to provide issuers with significantly more flexibility to conduct offerings more closely in time, even concurrently, without risk of integration;
- broadened the scope of permissible communications to allow certain "test-the-waters" communications regarding exempt offerings and to exempt "demo day" and similar events from the prohibition on general solicitation or advertising;
- relaxed the 506(c) verifications to be conducted for repeat investors;
- updated the financial disclosure requirements for Rule 506(b) offerings to non-accredited investors to align them with Regulation A;
- revised certain offering limits for Regulation D, Regulation A and Regulation Crowdfunding ("CF") offerings;
- updated the bad actor disqualification provisions for greater consistency among Regulation D, Regulation A and Regulation CF; and
- amended certain eligibility restrictions under Regulation A and Regulation CF and simplified certain Regulation A compliance requirements.

Annual Reporting Season Matters

Shareholder Proposals

In September, the SEC adopted amendments (available here) to modernize important aspects of the Rule 14a-8 process for shareholder proposals to be included in domestic SEC reporting company proxy statements (see our client memo here). The amendments:

- establish a tiered system of ownership and holding-period thresholds pursuant to which shareholder proponents will now need to hold $2,000, $15,000 or $25,000 of the company's securities for at least three, two or one year, respectively, in order to submit a proposal, subject to a transition period that allows shareholders meeting the current $2,000/one-year ownership threshold to submit proposals so long as they continue to hold such shares until 2023;
- clarify and enhance the "one proposal-per person" and the representative requirements;
- require that shareholder proponents be available for engagement with the company; and
- increase the resubmission thresholds for proposals that have previously been submitted by shareholder proponents to 5%, 15% and 25% for proposals that have been submitted 1, 2 or 3 times, respectively, in the last five years.

The amendments will apply to any proposal submitted for annual or special meetings held on or after January 1, 2022. Shareholders who, on January 4, 2021, meet the current ownership threshold of $2,000 of a company's securities entitled to vote on the proposal for at least one year and continuously own at least $2,000 of such securities through the date they submit a proposal, will be eligible to submit a shareholder proposal for any shareholder meetings held prior to January 1, 2023.

Proxy Voting Advice and Investment Adviser Voting Responsibilities

Also in September, the SEC adopted amendments (available here) to its proxy solicitation rules in regards to proxy voting advice (see our client memo here). The amendments, among other things:

- codify the SEC's longstanding view that proxy voting advice constitutes a solicitation under the proxy rules;
- clarify that a failure to provide material information (such as a proxy advisory firm's methodology, sources of information or conflicts of interest) would violate the antifraud provisions of the proxy rules; and
- require proxy advisory firms, subject to limited exceptions and conditions, to institute reasonable procedures to (i) provide companies with a copy of their initial voting advice at the same time or before dissemination to their clients and (ii) alert clients to written responses to the proxy voting advice by the subject companies.

The SEC also concurrently supplemented its prior guidance regarding the proxy voting responsibilities of investment advisers, with additional clarification on how investment advisers should (i) consider company responses to proxy voting advice under the amendments and (ii) act in a client's best interest when utilizing a proxy advisory firm's electronic vote management system (available here).

The amendments will be effective December 1, 2021, while the supplemental guidance became effective upon publication in the Federal Register *on September 3, 2020*. ISS reinstated its lawsuit seeking to vacate these changes (see here).

ISS Voting Policies

In November, ISS issued its final voting policies (available here) for the upcoming 2021 proxy season (see our client memo here). The new voting policies apply to shareholder meetings held after February 1, 2021.

ISS's most significant move this season may not be the updates to its voting policies, but rather the termination of its longstanding practice of providing draft proxy voting reports to S&P 500 companies, starting with meetings on or after January 1, 2021. In a letter announcing this change, ISS cited multiple reasons for this decision, including that its clients do not support the draft review process and that companies, instead of merely reviewing the drafts for factual accuracy as originally intended, have been using the early access to lobby for revisions. Under the SEC's proxy advisory rules adopted earlier this year (for our client memo, see here), ISS is not required to provide companies with draft reports.

Key updates for U.S. companies include:

- *Board diversity*. Starting in the 2022 proxy season, ISS will recommend against the nominating committee chair (and possibly other directors) at any Russell 3000 or S&P 1500 board with no apparent racial or ethnic diversity, unless there was diversity at the previous annual meeting and the board makes a firm commitment to appoint at least one racially or ethnically diverse director within a year. For the 2021 proxy season, ISS will highlight in its voting reports any such lack of diversity to "help investors identify companies with which to engage," but will not make any voting recommendations based on this factor.

- *Policy to support federal forum provisions that specify U.S. district courts generally as the exclusive forum for federal securities law litigation*. Adoption of a federal forum provision that specifies a particular district court will, however, result in a negative vote recommendation against directors.

- *Policy to support provisions that specify courts located in Delaware as the exclusive forum for corporate law matters for Delaware companies*, so long as there are no serious concerns about corporate governance or board responsiveness to shareholders. Provisions for other states will be considered on a case-by-case basis under specified factors. The policy also clarifies that ISS will recommend against provisions that specify a state other than a company's state of incorporation or that specify a particular local court as the exclusive forum for corporate law matters, and further, that adoption of such a provision would result in negative recommendations against directors.

- *Explicit policy to consider as non-independent any director with pay comparable to named executive officers*. While ISS currently has a policy that may, in some cases, classify a director receiving such pay as having a material relationship with the company and therefore non-independent, this is now explicit. ISS also limited its "executive director" classification (by moving employees of a company to another category) to assist investors that have executive director overboarding policies to better assess those positions. Other changes generally rearrange and consolidate its independence conditions, but are not expected to impact any vote recommendations.

Glass Lewis Voting Policies

Also in November, Glass Lewis issued its voting policies for the 2021 proxy season (available here). Key updates for U.S. companies include:

- *Board diversity*. Starting in 2022, Glass Lewis will recommend against the nominating committee chair of boards with fewer than two female directors, except that one female director will be sufficient at boards with six or fewer members. For the 2021 season, Glass Lewis will only note as a concern boards that do not meet the foregoing standard. Further, Glass Lewis will make recommendations in line with any state law requirements on diversity. Glass Lewis will also begin tracking the quality of disclosure on board diversity and skills in its reports for S&P 500 companies.

- *Board refreshment.* Glass Lewis will begin noting as a potential concern boards where the average tenure of non-executive directors is 10 years or more and no new independent directors have joined the board in the last five years. This concern will not be the sole basis for any recommendations against directors, but may contribute to such determination where there are other concerns.

- *Board environmental and social risk oversight*. Starting in 2022, Glass Lewis will generally recommend against the governance chair at S&P 500 companies that fail to provide explicit disclosure concerning their board's role in overseeing E&S issues. For the 2021 season, Glass Lewis will note as a concern when S&P 500 companies do not provide clear disclosure concerning the board-level oversight afforded to E&S issues.

- *SPACs.* Glass Lewis has added a new section detailing their approach on common SPAC issues, including Glass Lewis' general support of proposals seeking to extend business combination deadlines and that, absent evidence of an employment relationship or continuing material financial interest in the combined entity, Glass Lewis will generally consider former SPAC executives serving as directors of the combined entity to be independent.

The updates also include codification of factors in assessing short- and long-term incentive plans and other clarifying amendments.

Other SEC Updates

Electronic Signatures

As part of its modernization efforts, in November, the SEC adopted amendments allowing for electronic signature of documents filed with the SEC via EDGAR (available here). The SEC also revised rules and forms under the Securities Act, Exchange Act and Investment Company Act to allow the use of electronic signatures for other filings that contain typed, rather than manual, signatures (see our client memo here).

These amendments became effective December 4, 2020.

Auditor Independence

To modernize its auditor independence rules, in October, the SEC adopted amendments to certain auditor independence requirements set forth in Regulation S-X (available here). Under the amendments, certain relationships and services that previously would have run afoul of the independence requirements, and that the SEC believes do not impair the objectivity or impartiality of auditors, will be permitted (see our client memo here).

These amendments will become effective on June 9, 2021, though auditors may choose to voluntarily comply with the amendments on an early basis at any time, provided that the final amendments must be applied in their entirety from the date of such early compliance.

Resource Extraction Issuer Disclosures

In December, the SEC adopted final disclosure rules (available here) that will require resource extraction issuers to disclose payments made to the U.S. federal government or foreign governments for the commercial development of oil, natural gas or minerals (see our client memo here). The rule applies to SEC-reporting domestic issuers as well as foreign private issuers. The final rules seek to address the concerns highlighted in prior versions of the rules. *The final rules are not yet effective* - they will become effective 60 days after the date of publication in the *Federal Register* (which publication has not yet occurred).

The SEC simultaneously issued an order (available here) permitting issuers (domestic and foreign) to provide, in lieu of disclosure mandated by the final rules, resource extraction payment disclosures already required of them under (i) Canada's Extractive Sector Transparency Measures (ESTMA); (ii) the EU Accounting Directive 2013/34/EU; (iii) the EU Transparency Directive 2013/50/EU; (iv) the UK Reports on Payment to Governments Regulation 2014 or (v) the Norwegian Regulation on Country-by-Country Reporting.

Pending Proposals

Nasdaq Proposes Board Diversity Requirements for Listed Companies

In a watershed moment for corporate governance in the United States, on December 1, Nasdaq proposed board diversity and disclosure requirements as a condition to continued listing (available here). This is the latest in a series of developments spotlighting board diversity, including the enactment of quotas for female and diversity board membership for California-based companies and diversity disclosure requirements in other jurisdictions. If approved by the SEC, companies listed on Nasdaq would need to (i) report data on board diversity and (ii) have at least one female director and one director that self-identifies as an "underrepresented minority" or as LGBTQ+, or explain why they do not meet these board diversity requirements, as a condition to continued listing. These requirements would also apply to foreign issuers and smaller-reporting companies, with some accommodations (see our client memo here). Nasdaq has published additional resources for Nasdaq listed companies: 5 Things Nasdaq Issuers Listed Companies Should Know (available here), and FAQs (available here).

Direct Listings

In September, the SEC published proposed listing rule changes filed by Nasdaq (available here) on September 4 that would permit companies undertaking a direct listing on Nasdaq to raise capital. Under the revised rules, companies would be permitted to undertake an initial public offering and concurrent Nasdaq listing without the use of underwriters to market the shares. Currently, direct listings on Nasdaq are available only for secondary offerings by existing shareholders (see our client memo here). On December 17, the SEC instituted proceedings to determine whether to approve or disapprove this proposal. Submissions will be due by the date that is 21 days after publication of the SEC's order instituting the proceedings in the *Federal Register* (which publication has not yet occurred). Rebuttal comments will be due within 35 days of the publication date. The Council of Institutional Investors has urged the SEC to disapprove the Nasdaq proposal.

Nasdaq's proposal follows the recent NYSE rule change permitting primary direct floor listings, *i.e.*, direct listings with a primary capital raise (see our client memo here). The NYSE's rule was approved in August (available here) but its effectiveness has since been stayed pending the outcome of a petition to review the rule filed by the Council of Institutional Investors.

Proposed Modernization of Rule 701 and Form S-8

In November, the SEC proposed amendments to modernize the securities law framework for equity compensation offerings to employees and other service providers (available here). The proposed amendments are intended to reduce compliance burdens for issuers by simplifying the requirements of Rule 701 and Form S-8, and, if adopted, would benefit both domestic issuers and foreign private issuers (see our client memo here).

The key proposed amendments to Rule 701 and Form S-8 include:

- expanding the eligible recipients of securities issued under Rule 701 and Form S-8 to include, subject to certain conditions:
  - consultants and advisors that are entities;
  - former employees, with respect to post-termination grants in connection with prior employment or service;
  - former employees of acquired entities, with respect to the acquiring company securities issued in exchange or substitution for the acquired entity's securities (which would be a welcome relief in the M&A context for acquiring companies that roll-over equity awards of their target companies to acquiring company stock, as this would relieve the acquiring company of the costly obligation to register these rolled-over equity awards on Form S-3); and
  - employees of any subsidiary (not just wholly-owned or majority-owned subsidiaries);
- increasing two of the three calculations for the maximum amount of securities issuable pursuant to Rule 701, so that issuers could, in any 12-month period, sell securities in an amount up to the greater of:
  - 25% of assets (up from 15%);
  - $2 million (up from $1 million); or
  - 15% of the amount or class of securities offered (unchanged);
- relaxing the disclosure requirements for issuances under Rule 701 exceeding $10 million in any 12-month period, including by requiring these disclosures only for issuances in excess of the $10 million threshold, and relaxing the age of the required financial statements so that issuers need only prepare these semi-annually instead of quarterly;

- clarifying that issuers may use an automatically effective post-effective amendment to an existing Form S-8 to add plans, additional securities and additional classes of securities, instead of filing a new Form S-8; and

- clarifying that issuers may use a single Form S-8 to register an unallocated pool of securities underlying multiple incentive plans.

Proposal to Permit Equity Issuances to Gig Economy Workers

In a simultaneous, but separate, release, the SEC also proposed amendments to Rule 701 and Form S-8 (available here) that, if adopted, would permit, for a temporary five-year trial period, companies to offer equity compensation to "platform workers" (gig economy workers who provide services by means of an internet- or other technology-based marketplace platform) under Rule 701 and Form S-8 (see our client memo here).

Proposed Exemptive Order for "Finders"

In an effort to assist small businesses with their capital raising needs, in October, the SEC proposed an exemptive order (available here) which, if issued, would offer limited conditional exemptions from broker-dealer registration for natural persons who assist non-Exchange Act reporting issuers in raising capital from accredited investors ("Finders"). To assist non-reporting issuers in understanding the permissible activities, requirements and limitations set out in the proposed exemptive order, the SEC also posted two education tools on its website (available here). (See our client memo 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:

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