SEC Actions Impacting 2020:

A 2019 Year in Review

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Introduction

Despite the government shutdown extending into January 2019, the U.S. Securities and Exchange Commission (SEC) had a busy year publishing numerous final and proposed rules. Some of these actions will impact your upcoming annual reports and proxy statements. Below is a summary of significant SEC rulemaking from the past year. Contact the securities and capital markets professionals at Michael Best for more information about how these rules and proposed rules could affect you.

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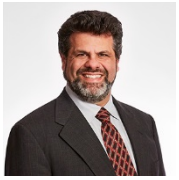

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SEC Actions Impacting 2020

Expansion of Regulation A to Public Reporting Companies

Effective January 31, 2019, SEC rules now allow public reporting companies to rely on the Regulation A (Reg A) exemption from registration for certain securities offerings. Reg A provides an exemption from registration under the Securities Act for offerings of securities up to $20 million for a Tier 1 offering and up to $50 million for a Tier 2 offering. Tier 1 offerings do not require audited financial statements or ongoing reporting with the SEC, while Tier 2 offerings require both audited financial statements and ongoing reporting. Under the amended Rule 257, a reporting company's reports under the Securities Exchange Act can now be used to satisfy the Reg A reporting requirements, so that a Reg A offering would not require any additional reporting by a reporting company.

Reg A offers a few advantages over the use of other available exemptions, including:

- the ability of issuers under Reg A to "test the waters" for investor interest before filing an offering circular;
- the fact that securities sold under Reg A are considered unrestricted for the purposes of buyer resale, which means that the required holding periods under Rule 144 do not apply; and
- the fact that Reg A Tier 2 offerings by issuers who are not listed on a national exchange preempt state law securities registration requirements, unlike S-1 registrations by those issuers.

Companies that are eligible to use Form S-3 are unlikely to forgo the benefits of an S-3 registration for a Reg A offering, but companies that are not eligible to use Form S-3 and are not listed on a national exchange may find Reg A an attractive alternative for raising equity capital.

Regulation S-K Disclosure Modernization

The SEC finalized one major rule revision and proposed a second major revision to Regulation S-K and associated regulations involving periodic reports and Form 10-K. The first revisions, issued on March 20, 2019 and effective May 2, 2019, addressed confidential treatment requests and other readability amendments. The second revisions, released August 8, 2019, focused on proposed changes to four disclosure items: developments in a registrant's business, narrative description of a registrant's business, description of legal proceedings, and risk factors.

1. Final Rules Effective May 2, 2019

Confidential Treatment Requests

- A registrant can now can redact most confidential information without filing a request if the redacted information:
  - is not material; and
  - would likely cause the registrant competitive harm if disclosed.
- Though disclosure is not required up front, SEC staff could selectively require registrants to provide analysis supporting a redaction decision, and could require registrants to later refile unredacted versions of filed agreements and exhibits.

MD&A

- *First year can be omitted* – A registrant may omit the discussion of the first of the required three fiscal years of discussion if it was already included in another registrant EDGAR filing and the registrant identifies the location of the discussion.
- *Year-to-year comparisons are no longer required* – Use of year-to-year comparisons is no longer required, and a registrant can use any presentation method that enhances a reader's understanding of the registrant's financial condition, change in financial condition, and results of operations.
- *Five year trend data can be omitted* – A registrant can omit selected five-year financial trend data.

Description of Securities

- A registrant is now required to provide a brief description of the registrant's capital stock, debt securities, warrants, rights, American Depositary Receipts, and other securities as an exhibit to Form 10-K.

Simplified Disclosure and Readability

The revised rules simplified disclosure and revised rules for readability in a number of areas:

- A registrant is only required to provide a description of physical property to the extent material.
- Section 16 filers are no longer required to provide reports directly to the registrant, and a registrant can rely on Section 16 reports filed on EDGAR to determine any Section 16 delinquencies.
- A registrant is required to disclose its trading symbol and the title of each class of its registered securities on the Form 10-K, 10-Q, and 8-K cover pages.
- A registrant is required, subject to a phase-in compliance schedule, to tag all, rather than only some, cover page information with inline XBRL.
- A registrant is no longer required to include as an exhibit to a filing any document or part of a document incorporated by reference in a filing if that document has already been filed by the registrant on EDGAR, and can instead include a hyperlink to the document or part of a document incorporated.

2. Proposed Rules Released August 8, 2019

General Description of Business

- *Non-exclusive list of topics* – The proposed rules provide a non-exclusive list of discussion topics, rather than providing required discussion topics. A registrant would only be required to discuss the topics that are material to an understanding of the developments in the registrant's business.
- *Five-year lookback eliminated* – The proposed rules eliminate the requirement to strictly provide a discussion of the development of a registrant's business over the last five years, and instead only require a discussion of general developments to the extent material.
- *Updates only, with references or hyperlinks* – In filings after a registrant's initial filing, a registrant would need only to update developments material to an understanding of the general development of its business, focusing on those developments that occurred during the relevant reporting period, and could include references and hyperlinks to other filings that provide or expand on the discussion.
- *Discussion of business strategy now required* – A registrant would be required to discuss any material changes to its business strategy, especially where the registrant disclosed an initial business strategy in an initial filing.

Narrative Description of Business

- *Fewer, nonexhaustive discussion topics* – Similar to the general description of business proposal, the proposed rules would provide a shorter nonexhaustive list of general description topics and would only require a registrant to discuss the topics that are material.
- *Human capital resources added as a topic* – One of the nonexhaustive topics would be a discussion of human capital resources, which is not currently included in the discussion topic list. The topic would be particularly material for registrants that depend heavily on the talent and expertise of employees.
- *Impact of government relations* – The proposed rules would require a registrant to discuss any material impact of a government regulation, rather than discussing only environmental regulations.

Legal Proceedings

- *Hyperlinks or cross-references* -- The proposed rules would specifically allow a registrant to provide required information about legal proceedings via a hyperlink or cross reference to legal proceedings located elsewhere in a filing.
- *Environmental proceeding disclosure* – The proposed rules would require a registrant to disclose any environmental proceeding where the monetary sanctions involved are likely to be more than $300,000, adjusting upward the current threshold of $100,000.

Risk Factors

- *Summary required for lengthy risk factor disclosure* – A registrant would be required to provide a summary of its risk factor disclosures if its risk factor disclosures exceed 15 pages.
- *"Material" over "most significant*" – A registrant would be required to discuss "material" risk factors, a change from the current "most significant risk factors" standard.
- *Generic risk factors appear last* – A registrant that includes a discussion of generic risk factors would be required to list them at the end of the risk factor disclosure under a heading titled "Generic Risk Factors."

After the consideration of comments, these proposed amendments could become effective in 2020.

Proposed Amendments to Accelerated Filer and Large Accelerated Filer Definitions

On May 9, 2019, the SEC proposed amendments to the accelerated filer and large accelerated filer definitions "tailoring" the types of issuers that are included in these two categories and revising the transition thresholds for accelerated and large accelerated filers. These amendments would:

- exclude smaller reporting companies with annual revenues of less than $100 million from the definitions of accelerated filer and large accelerated filer;
- increase the transition thresholds for becoming a non-accelerated filer from $50 million to $60 million in market value and for exiting large accelerated filer status from $500 million to $560 million in market value; and
- add a revenue test to the transition thresholds for exiting both accelerated filer and large accelerated filer status.

Proxy Voting Advice Reforms

The SEC has initiated a series of proxy voting reforms. In 2019, these targeted efforts included both the release of guidance and proposed amendments to the Exchange Act.

1. Interpretations and Guidance

On August 21, 2019, the SEC published guidance regarding the applicability of proxy voting responsibilities to investment advisors and interrelated interpretations and guidance regarding the applicability of proxy rules to proxy advisory firms.

Investment Advisors

Investment advisors are often called upon by their clients to make voting determinations on their behalf. Investment advisors owe fiduciary duties, including the duty of care and loyalty, to their clients and must ensure that these votes are in the best interests of their clients, not placing the advisor's interests ahead of the clients' interests. The SEC's guidance assists investment advisors

in complying with these fiduciary duties, particularly in the context of advice from third parties including proxy advisory firms. The guidance also provides methods an investment advisor may use to evaluate a proxy advisory firm and what it could do if it determines that the recommendations of a proxy advisory firm are based on factual errors, incompleteness, or methodological weaknesses, including:

- The proxy advisory firm's engagement with issuers, including the firm's process for ensuring that it has complete and accurate information about the issuer and each particular matter, and the firm's process, if any, for investment advisors to access the issuer's views about the firm's voting recommendations.
- The proxy advisory firm's efforts to correct any identified material deficiencies in the proxy advisory firm's analysis.
- The proxy advisory firm's disclosure to the investment advisor regarding the sources of information and methodologies used in formulating voting recommendations or executing voting instructions.
- The proxy advisory firm's consideration of factors unique to a specific issuer or proposal when evaluating a matter subject to a shareholder vote.

Proxy Advisory Firms

Proxy advisory firms provide guidance to investment advisors, mutual funds, and other stockholders on how to vote on proposals at annual and special meetings of stockholders. Companies have long awaited SEC input on the applicability of SEC rules and regulations to proxy advisory firms, who have significant influence over stockholder votes on company policies, governance, and compensation. The SEC's guidance to proxy advisory firms helps them to ensure compliance with SEC rules and regulations, particularly in the context of anti-fraud provisions.

The SEC's guidance to proxy advisory firms was that advice provided by such firms generally constitutes a "solicitation" under the federal proxy rules, thus subjecting the advice to securities laws liability. The SEC stated in its Press Release, "Under Exchange Act Rule 14a-1(l), a solicitation includes, among other things, a 'communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy,' and includes communications by a person seeking to influence the voting of proxies by shareholders, regardless of whether the person itself is seeking authorization to act as a proxy." By engaging in solicitations, proxy advisory firms are subject to the anti-fraud provisions of the Exchange Act Rule 14a-9. Advice in those solicitations may not contain any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact.

A solicitation can only be made if disclosure of the underlying facts, assumptions, limitations, and other information is provided to mitigate Rule 14a-9 concerns. The SEC provided the following as possible types of information that could be provided, if failure to provide such information would render statements false or misleading:

- An explanation of the methodology used to formulate its voting advice.

- To the extent that the voting advice is based on information other than a registrant's public disclosures, the source of this information and the extent to which these sources differ from public disclosures.
- Disclosure of any material conflicts of interest that arise in connection with providing advice in sufficient detail so that clients can assess the relevance of those conflicts.

The SEC stated in its press release that its interpretation that proxy voting advice constitutes a solicitation subject to federal proxy rules, "does not affect the ability of proxy advisory firms to continue to rely on the exemptions from the federal proxy rules' filing requirements. These exemptions, found in Rule 14a-2(b), among other things, provide relief from the obligation to file a proxy statement, as long as the advisory firm complies with the exemption's conditions."

2. Proposed Amendments

On November 5, 2019, the SEC proposed amendments to the Exchange Act proxy rules governing proxy solicitations by proxy advisory firms.

Because the SEC has determined that proxy voting advice constitutes a solicitation, the SEC has asserted rulemaking authority over proxy advice to ensure that it enables investors and investments advisors to make informed investment decisions.

Proposed codification under Rule 14a-1(a) and Section 14(a) that such advice is a solicitation

Section 14(a) provides rules to ensure that proxy solicitations do not contain deceptive or inadequate disclosure. As the term solicitation is not defined, the SEC has broad authority to determine which solicitations are governed by Section 14(a). The SEC proposed to modify Rule 14a-1(a) to make clear that the terms "solicit" and "solicitation" include any voting advice that makes a recommendation to a stockholder as to a stockholder proposal, where such advice is furnished by a person who markets expertise as a provider of such advice and sells such advice for a fee. Under this definition, the SEC states that unprompted requests to investment advisors for voting advice are not solicitations.

Proposed amendments to Rule 14a-2(b)

Recognizing that proxy voting advice plays a valuable role in the voting process, the SEC has proposed to exempt such advice from the filing and information requirements so long as the proxy advisory firms disclose any conflicts of interest and provide issuers with an opportunity to review and comment on such advice in advance. An issuer would also have an opportunity to provide a statement in response to the advice. The proposed amendments to Rule 14a-2(b) also provide a safe harbor for proxy advisory firms that make a good faith and reasonable effort to comply with the rule.

Proposed amendments to Rule 14a-9

Finally, under Rule 14a-9, which prohibits any proxy solicitation from containing false or misleading statements or omissions with respect to any material fact, the SEC proposed additional examples of what information may need to be disclosed so that such statements are not misleading, including the "methodology used to formulate the proxy voting advice, sources of

information on which the advice is based, or material conflicts of interest that arise in connection with providing the advice, without which the proxy voting advice may be misleading."

In 2020, the SEC is likely to continue its efforts of proxy voting reform. After the consideration of comments, these proposed amendments could become effective in 2020.

Modernization of Shareholder Proposals and Treatment of No-Action Requests

1. Treatment of No-Action Requests

On September 9, 2019, the SEC announced changes in the treatment of no-action requests to exclude shareholder proposals. The SEC stated that, "[t]he staff will continue to actively monitor correspondence and provide informal guidance to companies and proponents as appropriate. In cases where a company seeks to exclude a proposal, the staff will inform the proponent and the company of its position, which may be that the staff concurs, disagrees or declines to state a view, with respect to the company's asserted basis for exclusion. Starting with the 2019-2020 shareholder proposal season, however, the staff may respond orally instead of in writing to some no-action requests. The staff intends to issue a response letter where it believes doing so would provide value, such as more broadly applicable guidance about complying with Rule 14a-8."

In cases where the SEC declines to state a view, a company may choose to exclude the shareholder proposal, but a party could go to state court to seek a resolution when there is no agreement between the parties. The decision to exclude a proposal where the SEC declines to state a view may also affect how proxy advisors assess the company.

2. Proposed Amendments to Modernize the Shareholder Proposal Rule

On November 5, 2019, the SEC announced new proposed amendments to rules governing shareholder proposals. Among other things, the proposal would amend Exchange Act Rule 14a-8 to:

- update the criteria that a shareholder must satisfy to be eligible to require a company to include a proposal in its proxy statement to require that the shareholder hold continuously:
  - $2,000 of the company's securities entitled to vote on the proposal for at least three years;
  - $15,000 of the company's securities entitled to vote on the proposal for at least two years; or
  - $25,000 of the company's securities entitled to vote on the proposal for at least one year;"
- add documentation requirements for shareholders using representatives;
- require that the shareholder make themselves available to meet with the company in person or via teleconference no less than 10 calendar days, nor more than 30 calendar days, after submission of the shareholder proposal and provide contact information;
- require that representatives of shareholders submit no more than one proposal at a company's shareholder meeting;

- increase the level of support a proposal must receive to be eligible for resubmission at future meetings to:
  - less than 5% if previously voted on once;
  - less than 15% if previously voted on twice; or
  - less than 25% if previously voted on three or more times; and
- allow for exclusion of a proposal that has been previously voted on three or more times in the last five years, notwithstanding having received at least 25 percent of the votes cast on its most recent submission, if the proposal (i) received less than 50 percent of the votes cast and (ii) experienced a decline in shareholder support of 10 percent or more compared to the immediately preceding vote.

"Test-the-Waters" Accommodation Available to All Issuers

On September 26, 2019, the SEC announced the adoption of Securities Act Rule 163B, which expands to all issuers the "test-the-waters" accommodation, which had previously only been available to issuers that qualified as emerging growth companies.

The Jumpstart Our Business Startups Act (JOBS Act) was enacted in 2012 with the intent to encourage capital formation of small businesses by easing many of the burdensome requirements under federal securities laws. As one of the many ways the JOBS Act encouraged capital formation for small businesses, it permitted those issuers meeting the definition of an emerging growth company (and persons authorized to act on behalf of an emerging growth company) to communicate with qualified institutional buyers and institutional accredited investors regarding a proposed offering before filing a registration statement. This "test-the-waters" accommodation allowed emerging growth companies to gauge market interest before committing to the costly process associated with initial public offerings and other registered securities offerings.

With the adoption of Rule 163B, all issuers—including nonreporting issuers, emerging growth companies, non-emerging growth companies, well-known seasoned issuers, and investment companies—and their authorized representatives, including underwriters, will be able to take advantage of the test-the-waters accommodation. The SEC press release notes several technical considerations under Rule 163B, including: (i) that there are no filing or legending requirements; (ii) that communications are deemed "offers" as defined under the Securities Act; and (iii) that issuers must consider whether any information in a test-the-waters communication would trigger disclosure obligations under Regulation FD. In commenting on Rule 163B, SEC Chairman Jay Clayton stated, "[i]nvestors and companies alike will benefit from test-the-waters communications, including increasing the likelihood of successful public securities offerings." The adoption of Rule 163B is one of many initiatives intended to encourage companies to access U.S. public markets, which has recently been an area of focus for the SEC.

Rule 163B became effective on December 3, 2019, 60 days after its publication in the Federal Register. In 2020, the SEC is likely to see an increase of a variety of issuers taking advantage of Rule 163B, which could lead to an increase in successful public offerings.

SEC Fee Increase and Modernization

1. Fee Rate Advisory for Fiscal Year 2020

On August 23, 2019, the SEC announced that in fiscal year 2020, the fees that public companies and other issuers pay to register their securities are $129.80 per million dollars.

2. Proposed Filing Fee Disclosure and Payment Modernization

On October 24, 2019, the SEC proposed new rules to modernize filing fee disclosure and payment methods. These rules would amend most fee-bearing forms, schedules, statements, and rules to include all information for how the fee is calculated in a structured format. The amendments would also add ACH transfers as a payment method and eliminate payment by paper checks and money orders. The SEC expects that these enhancements will create a more efficient fee process.

Expanded Definitions of Accredited Investor and Qualified Institutional Buyer

On December 18, 2019, the SEC proposed amendments that would expand the definitions of "accredited investor" and "institutional buyer" in Rule 144A, including by adding new categories of individuals and entities that would qualify. These definitions determine under many SEC rules which individuals and entities may participate and invest in in private placement offerings, including under Rule 506(b) and 506(c) of Regulation D.

Significantly, the proposed amendments do not change the basic definitions for investors, which for individuals require income of $200,000 in the past two years (or joint income of $300,000) or a net worth of greater than $1 million, excluding a primary residence.

Rather, the proposed amendments to the accredited investor definition would add new categories of (i) qualifying individuals based on financial sophistication as measured by professional knowledge, experience, certifications, or (ii) qualifying entities based on the entity's structure and assets invested or under management. The new categories would include:

- individuals with professional certifications, including those with a Series 7, 65 ,or 82 license, whether or not actively practicing in those fields;
- individuals investing in a private fund who are "knowledgeable employees" of the fund;
- adding to the list of eligible entities LLCs (LLCs are currently excluded from the definition because LLCs were less common when the rule was adopted), registered investment advisors (RIAs), rural business investment companies (RBICs);
- "catch all" entities with greater than $5 million in investments that are not formed for the specific purpose of acquiring the securities being offered, including Indian tribes and entities not already included in the list (such as future, yet-to-be conceived entity forms);
- "family offices" and their "family clients," (as those terms are defined in the Investment Advisers Act) with at least $ 5 million in assets under management; and

- "spousal equivalents," or cohabitants occupying a relationship generally equivalent to that of a spouse, qualifying together.

The proposed amendments would add corresponding amendments to other SEC rules including changes to the qualified institutional buyer (QIB) definition in Rule 144A to include:

- LLCs and RBICs that meet the existing qualified institutional buyer $100 million in securities owned threshold;
- "catch-all" entities, or entities not already included in the list (such as future, yet-to-be conceived entity forms), where the entities satisfy the existing $100 million threshold and are not formed for the specific purpose of acquiring the securities being offered.

The proposals are subject to a 60-day public comment period after their publication in the Federal Register on December 26, 2019.

Statement on the Role of Audit Committees in Financial Reporting

Finally, to ring in the New Year, the SEC published a Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities. The statement does not include any new information or requirements for audit committees, rather, the SEC provides observations and reminders on areas of focus for audit committees. These include topics of tone at the top, auditor independence, use of GAAP or ICFR, non-GAAP measures, LIBOR,and critical audit matters (CAMs).

Contact the securities and capital markets professionals at Michael Best for more information about how these rules and proposed rules could affect you.

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