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# The Securities Law Crystal Ball

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At the beginning of each new year, we find ourselves engaged in discussions of the evolving securities regulatory landscape and the changes that we anticipate may occur. We have done this for many years now. Each January we also begin by reminding ourselves of the E.T. Bell quote, “time makes fools of us all. Our only comfort is that greater shall come after us.” That said, we offer some thoughts concerning the securities reforms that the U.S. Congress and the Securities and Exchange Commission (the “Commission”) may consider in 2017.

In recent years, the Commission has focused on implementation of the rulemaking requirements of the Dodd-Frank Act, the JOBS Act, and the FAST Act. At least in the case of the Dodd-Frank Act, the Commission was required to promulgate rules relating to executive compensation, such as pay ratio disclosure, say-on-pay vote, pay-versus-performance disclosure and related requirements, which are regarded as burdensome to public companies. Various other specialized disclosure requirements, such as those relating to conflict minerals, extractive industries and mine safety, also were required by the Dodd-Frank Act. The Financial CHOICE Act (“CHOICE Act”) proposes to repeal a number of these Dodd-Frank Act requirements. The CHOICE Act also includes measures that would expand some of the capital formation-related initiatives contained in the JOBS Act and the FAST Act. Of course, the Commission on its own undertook amendments to various rules in order to reduce burdens on smaller issuers, such as proposed amendments to the definition of “smaller reporting company” that would have the effect of making available to a broader number of issuers scaled disclosure requirements and other accommodations. Presumably, the Commission, under the Trump administration, would seek to adopt these proposed rules. Finally, the Com-

mission, spurred in part by the mandate in the JOBS Act that it review the disclosure requirements of Regulation S-K, undertook the disclosure effectiveness initiative. This initiative has as its objective removing repetitive and outdated requirements and streamlining public company disclosures in order to make these more user-friendly for investors. Furthering this effort would seem consistent with the pro-capital formation and anti-regulation themes advanced by the Trump administration.

Below, we review some of the proposed measures, including a few included in the CHOICE Act, that may be on the congressional agenda or on the Commission's agenda, as well as our own views regarding areas that require attention. The possible changes can be grouped into the following categories: changes that would provide relief for smaller and private companies; changes that would promote capital formation; and changes that would modernize or simplify disclosure requirements.

## **Relief for Smaller and Private Companies**

**Smaller Reporting Company.** As discussed above, the Commission proposed amendments in June 2016 that would modify the definition of “smaller reporting company” (SRC) in order to expand the number of companies that would have this status. Currently, a company qualifies as an SRC if it has a public float of less than \$75 million. The amendments would change the threshold to \$250 million. Moving forward with these amendments would be helpful to smaller and mid-cap public companies. Also, on balance, smaller companies weighing the costs of becoming a public company might regard this change favorably.

**Section 404(b) Relief.** The CHOICE Act would modify the exemption from compliance with Sarbanes-Oxley Act section 404(b) relating to the auditor's attestation of a company's internal control over financial reporting and make the exemption applicable to issuers with a market capitalization of up to \$250 million. The CHOICE Act also would provide a temporary section 404(b) exemption for “low-revenue issuers” that are no longer emerging growth companies (EGCs) and are not large accelerated filers and whose revenues are below a specified threshold. These measures also might reduce the costs associated with being a reporting company for smaller and mid-cap companies.

**Stock-Based Compensation.** Section 1006 of the CHOICE Act would increase the threshold for disclosures relating to compensatory benefit plans by requiring that Rule 701 be amended and that the threshold triggering additional disclosure requirements for issuers be raised.

**XBRL.** The CHOICE Act would provide certain exemptions for EGCs and other smaller companies from Extensible Business Reporting Language (XBRL) requirements.

## Changes That Would Promote Capital Formation

**Shelf Registration Eligibility.** The CHOICE Act would expand the eligibility for use of a registration statement on Form S-3.

**Business Development Companies.** The CHOICE Act includes provisions that would modify certain of the Securities Act requirements relating to business development companies (BDCs), change the asset coverage requirements for BDCs, and allow BDCs to own interests in an investment adviser. These changes would enable BDCs to make additional credit available to smaller, privately held companies.

**"JOBS Act Extensions."** There are various other measures contained in the CHOICE Act that aim to address perceived shortcomings of certain JOBS Act provisions. For example, there are various provisions that would "correct" the existing Regulation Crowdfunding framework and make the crowdfunding exemption available to special purpose vehicles or funds. The CHOICE Act would also create a new safe harbor under section 4 of the Securities Act for certain "micro offerings" of securities involving proceeds not exceeding \$500,000 in any twelve-month period. In practice, it is difficult to see how these changes would have a significant impact on capital formation.

**Codification of No-Action Letter Guidance.** Various provisions of the CHOICE Act would codify existing no-action letter guidance, including guidance related to the types of communications that are not considered "general solicitations." It is unclear why such changes are needed given that there is little ambiguity as to matters already addressed by the Commission Staff.

**Small Business Interests.** There are various measures contained in the CHOICE Act that would require that the interests of small businesses be considered, including, for example, a requirement for a small business advocate, and a requirement that the Commission formally review the recommendations of the Commission’s Government-Business Forum on Capital Formation. While these measures purportedly promote capital formation, it is difficult to ascertain any practical benefit.

**Other Measures to Consider.** In our view, there are a number of other measures that merit attention and that would directly promote capital formation. The Commission Staff delivered its report on the definition of “accredited investor.” The report suggested a number of revisions, including permitting individuals with a minimum amount of assets to qualify, permitting individuals that possess certain professional credentials to qualify, and permitting individuals with experience investing in exempt offerings to qualify as accredited investors. The CHOICE Act also would include a person who is a “knowledgeable employee” of a private fund or the fund’s investment adviser as an “accredited investor.” Amending the “accredited investor” definition would provide additional investors the opportunity to participate in private offerings, which, in turn, would promote capital formation. The Commission should consider amending the eligibility requirements for shelf registration for issuers that have a market capitalization of less than \$75 million and currently are limited in their ability to conduct primary issuances in reliance on their shelf registration statements. The Commission should review with the national securities exchanges the rules of the exchanges in respect of shareholder vote requirements in connection with certain offerings. These rules are often referred to as the “20 percent rules,” and can have a particularly punitive effect on smaller and mid-cap issuers. The Commission revamped many of the communications rules for the largest and most sophisticated issuers in 2005 as part of Securities Offering Reform. Given the pace of technological changes affecting access to information, it is time for a more comprehensive review of the offering-related and research-related communications rules as they affect all issuers, not just well-known seasoned issuers. The Commission also should consider whether, in light of the now well-established trend of companies remaining private longer and deferring their initial public offerings, some reporting requirements

ought to be imposed on companies that have a dispersed stockholder base. Finally, the Commission should consider presenting all of its integration-related safe harbors and integration guidance in a single release for ease of reference by market participants.

## **Changes That Would Modernize or Simplify Disclosure Requirements**

Above, we referred to the Commission Staff's review of outdated, repetitive disclosure requirements. During late 2015, the Commission published a request for comment regarding various requirements of Regulation S-X. During 2016, the Commission continued its focus on disclosure requirements and issued a concept release on the business and financial disclosure requirements under Regulation S-K. The Commission issued proposed rules relating to disclosure simplification, which would eliminate disclosure requirements that have become redundant in light of other Commission requirements or disclosures required by accounting principles. The Commission also issued a release relating to the hyperlinking of exhibits to public filings, and a request for comment on the Part 400 rules of Regulation S-K. Finally, at the end of the year, the Staff of the Commission delivered the report required under the FAST Act regarding modernization and simplification of Regulation S-K requirements. Advancing all of the work undertaken by the Commission relating to disclosure reform and simplification and adopting amendments to Regulation S-K consistent with the Staff's recommendations should be an important priority.

## **Conclusion**

We have read and listened to commentators who explain that the 2016 U.S. election results indicate that, among other things, Americans have become increasingly concerned about job creation, capital formation, and the impact of burdensome regulations on companies. Both the Congress and the Commission have been focused on these issues for a number of years. It may be that the changed political landscape may provide the Commission and the Staff with enhanced capability to complete the securities regulatory reforms

that were already under way, as well as to undertake additional initiatives. For securities lawyers, this prospect is extremely interesting. We hope that next January, when we look back at 2017, time will not have done to us what it has done so reliably in the past.

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Anna T. Pinedo and James R. Tanenbaum are the authors of [Exempt and Hybrid Securities Offerings](#).

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