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SEC PROPOSES AMENDMENTS REGARDING RULE 10b5-1 PLANS AND RELATED DISCLOSURES

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On December 15, 2021, the U.S. Securities and Exchange Commission (the "SEC") proposed amendments to the affirmative defense in Rule 10b5-1(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and proposed a number of changes to disclosure requirements applicable to issuers and insiders.[1] The SEC described the proposed amendments as intended to address "critical gaps in the SEC's insider trading regime and to help shareholders understand when and how insiders are trading in securities for which they may at times have material nonpublic information."

If adopted after a 45-day comment period, these proposed amendments would:

- Update the requirements for the affirmative defense, including: imposing a cooling-off period before trading could commence under a plan; prohibiting overlapping trading plans; and limiting single-trade plans to one trading plan per 12-month period.
- Require directors and officers to furnish written certifications to the issuer that they are not aware of any material nonpublic information when they enter into trading plans.
- Expand the existing good faith requirement to require that Rule 10b5-1 plans *operate* in good faith.
- Require issuers to disclose in quarterly and annual filings: their policies and procedures related to insider trading; and their practices around the timing of option grants and the release of material nonpublic information.
- Require insiders to disclose the use of Rule 10b5-1 plans in Forms 4 and 5.
- Require that *bona fide* gifts of securities, which are currently permitted to be reported by insiders on Form 5, be reported more quickly on Form 4.

Background

Adopted over 20 years ago, Rule 10b5-1 provides an affirmative defense against allegations of insider trading by companies and their insiders engaging in transactions in the company's stock,

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even while in possession of material nonpublic information at the time of trading, through plans that are set up in advance. Over the years, academic studies have suggested that insiders with Rule 10b5-1 plans may achieve better returns than those not trading pursuant to Rule 10b5-1 plans. Those studies, as well as situations where insiders appeared to conduct questionable transactions under Rule 10b5-1 plans, have created negative perceptions about the use of Rule 10b5-1 plans by issuers and insiders.

In 2007, Linda Chatman Thomsen, then the Director of the SEC's Division of Enforcement, delivered a speech highlighting concerns about the use of Rule 10b5-1 plans.[2] At the time, she said that the SEC would probe issues associated with the use of Rule 10b5-1 trading plans by insiders, and those warnings by the SEC Staff continued for a few years after that speech. Citing academic studies, Thomsen noted that executives who trade within a Rule 10b5-1 plan outperformed their peers who trade outside such a plan. In response, she noted that "[w]e and others are looking at the disclosures surrounding 10b5-1 plans. We're looking at multiple and seemingly overlapping 10b5-1 plans and at asymmetrical disclosure around plans—that is, disclosure of entry into a 10b5-1 plan, without timely disclosure of related plan modifications or terminations."

In 2013, the Council of Institutional Investors (the "CII") submitted a rulemaking petition to the SEC, expressing concerns about Rule 10b5-1 plans.[3] The CII requested that the SEC consider issuing interpretive guidance or adopting amendments to Rule 10b5-1 that would require Rule 10b5-1 plans to be adopted with the additional protocols or guidelines that the CII believed would curb the potential for abuse of Rule 10b5-1 trading plans.

Following recent legislative efforts to compel the SEC to act on Rule 10b5-1 plans, in June 2021 SEC Chair Gary Gensler said that Rule 10b5-1 plans had led to "real cracks in our insider trading regime" and announced that he had asked the SEC Staff to provide recommendations on how the SEC might "freshen up" Rule 10b5-1. Gensler indicated that the Staff would look into possible reforms to Rule 10b5-1. Gensler's comments were followed by recommendations to amend Rule 10b5-1 from the SEC's Investor Advisory Committee.[4]

In the Proposing Release, the SEC states:

> We share the concern about the prevalence of trading practices by corporate insiders and issuers that suggest the misuse of material nonpublic information. We also understand that some issuers have engaged in a practice of granting stock options and other equity awards with option-like features to executive officers and directors in coordination with the release of material nonpublic information. In addition, there is research indicating that some corporate insiders may be opportunistically timing gifts of securities while aware of material nonpublic information relating to such securities. These practices can undermine the public's confidence and

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expectations of honest and fair capital markets by creating the appearance that some insiders, by virtue of their positions, do not play by the same rules as everyone else.

Proposed Amendments to Rule 10b5-1

Rule 10b5-1(c)(1) establishes an affirmative defense to Rule 10b-5 liability for a trade if the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan. A person asserting a Rule 10b5-1(c)(1) defense must satisfy several conditions:

- The person must demonstrate that, before becoming aware of material nonpublic information, they had entered into a binding contract to purchase or sell the security, provided instructions to another person to execute the trade for the instructing person's account, or adopted a written plan for trading the securities;
- The person must demonstrate that the applicable contract, instructions, or plan: (i) specified the amount of securities to be purchased or sold, price, and date; (ii) provided a written formula or algorithm, or computer program, for determining amounts, prices, and dates; or (iii) did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who exercised such influence was not aware of the material nonpublic information when doing so; and
- The person must demonstrate that the purchase or sale was pursuant to the prior contract, instruction, or plan.

Rule 10b5-1(c)(1) states that a purchase or sale is not pursuant to a contract, instruction, or plan if, among other things, the person who entered into the arrangement altered or deviated from the contract, instruction, or plan, or entered into or altered a corresponding or hedging transaction or position with respect to the securities. The rule also provides that the affirmative defense of a trading arrangement is only available if the trading arrangement was entered into "in good faith and not as part of a plan or scheme to evade the prohibitions" of the rule.

Cooling-Off Period

Currently, Rule 10b5-1(c)(1) does not impose any waiting period between the date on which the trading arrangement is adopted and the date of the first transaction to be executed under the trading arrangement, although in practice many insiders include a waiting period in their Rule 10b5-1 plans. Rule 10b5-1 plan guidelines that issuers adopt as part of their insider trading prevention programs often require waiting periods, although the term of the waiting period that is prescribed varies.

The SEC proposes to amend Rule 10b5-1(c)(1) to add as a condition to the availability of the affirmative defense:

- A minimum 120-day cooling-off period after the date of adoption of any Rule 10b5-1(c)(1) trading arrangement (including adoption of a modified trading arrangement) by a director or officer (as defined in Exchange Act Rule 16a-1(f)) before any purchases or sales under the new or modified trading arrangement; and
- A minimum 30-day cooling-off period after the date of adoption of any Rule 10b5-1(c)(1) trading arrangement by an issuer before any purchases or sales under the new or modified trading arrangement.

Under the proposed amendments, for directors and officers subject to Exchange Act Section 16 reporting, and for issuers, the Rule 10b5-1(c)(1) affirmative defense would only be available for a trading arrangement that includes a cooling-off period that delays transactions under the trading arrangement for at least 120 or 30 days (whichever is applicable) after the date of adoption of any new or modified trading arrangement. The proposed amendments also include a note clarifying that a "modification" of an existing Rule 10b5-1(c)(1) trading arrangement, including cancelling one or more trades, would be deemed equivalent to terminating the plan in its entirety, and the cooling-off period would therefore apply after a "modification" before any new trades could commence.

The SEC notes in the Proposing Release that applying a cooling-off period to directors and officers is appropriate "because such individuals are more likely than others to be aware of material nonpublic information in the general

course of events, and also more likely to be involved in making or overseeing key corporate decisions that have the potential to affect the issuer's stock price, including decisions about the timing of the disclosure of such information." The SEC also indicates that it is appropriate to apply a cooling-off period to issuers because it addresses concerns that issuers may conduct stock buybacks while they are aware of material nonpublic information.

Director and Officer Certifications

The SEC proposes to amend Rule 10b5-1(c)(1)(ii) to impose a certification requirement as a condition to the affirmative defense. Under the proposed amendment, if a director or officer of the issuer of the securities adopts a Rule 10b5-1 trading arrangement, as a condition to the availability of the affirmative defense, such director or officer would be required to promptly furnish to the issuer a written certification at the time of the adoption of a new/modified trading arrangement.

The certification would require a director or officer to certify at the time of the adoption of the trading arrangement:

- That they are not aware of material nonpublic information about the issuer or its securities; and
- That they are adopting the contract, instruction, or plan in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

In the Proposing Release, the SEC indicates that the proposed certification requirement "is intended to reinforce directors' and officers' cognizance of their obligation not to trade or adopt a trading plan while aware of material nonpublic information, that it is their responsibility to determine whether they are aware of material nonpublic information when adopting Rule 10b5-1 plans, and that the affirmative defense under Rule 10b5-1 requires them to act in good faith and not to adopt such plans as part of a plan or scheme to evade the insider trading laws."

The proposed amendment includes an instruction that a director or officer seeking to rely on the affirmative defense should retain a copy of the certification for a period of 10 years. The proposed amendment would not require a director, officer, or the issuer to file the certification with the SEC. The SEC indicates that the proposed certification would not be an independent basis of liability for directors or officers under Exchange Act Section 10(b) and Rule 10b-5. Rather, the SEC indicates in the Proposing Release that "the proposed certification would underscore the certifiers' awareness of their legal obligations under the federal securities law related to the trading in the issuer's securities."

Restricting Multiple Overlapping Rule 10b5-1 Trading Arrangements and Single-Trade Arrangements

In the Proposing Release, the SEC indicates that it is "concerned that a person could circumvent the proposed cooling-off period by setting up multiple overlapping Rule 10b5-1(c)(1) trading arrangements and deciding later which trades to execute and which to cancel after they become aware of material nonpublic information but before it is publicly released." As a result, the SEC proposes to amend Rule 10b5-1(c)(1) to eliminate the affirmative defense for any trades by a trader who has established multiple overlapping trading arrangements for open market purchases or sales of the same class of securities. Under the proposed amendment, the affirmative defense would not be available for trades under a trading arrangement when the trader maintains another trading arrangement, or subsequently enters into an additional overlapping trading arrangement, for open market purchases or sales of the same class of securities.

The SEC indicates that the proposed amendment would not apply to transactions directly with the issuer, such as acquiring shares through participation in employee stock ownership plans or dividend reinvestment plans.

The SEC also proposes to amend Rule 10b5-1(c)(1)(ii) to limit the availability of the affirmative defense for a trading arrangement designed to cover a single trade, so that the affirmative defense would only be available for one single-trade plan during any 12-month period. Under this proposed amendment, the affirmative defense would not be available for a single-trade plan if the trader had, within a 12-month period, purchased or sold securities pursuant

to another single-trade plan. The SEC cites in support of this amendment recent research which indicates that single-trade plans are consistently loss avoiding and often precede stock price declines.

Requiring That Trading Arrangements Be Operated in Good Faith

Rule 10b5-1 affirmative defense is available only if a trading arrangement was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of the rule. The SEC proposes to amend Rule 10b5-1(c)(1)(ii) to add the condition that a contract, instruction, or plan be "operated" in good faith. In the Proposing Release, the SEC indicates that to further require that the trading arrangement be *operated* in good faith "would help deter fraudulent and manipulative conduct and enhance investor protection throughout the duration of the trading arrangement." The SEC also indicates that the proposed amendment is intended to make clear that "the affirmative defense would not be available to a trader that cancels or modifies their plan in an effort to evade the prohibitions of the rule or uses their influence to affect the timing of a corporate disclosure to occur before or after a planned trade under a trading arrangement to make such trade more profitable or to avoid or reduce a loss."

Additional Disclosures Regarding Rule 10b5-1 Trading Arrangements

Other than disclosure currently required by Form 144 (which requires a seller to disclose the date of adoption of a Rule 10b5-1 plan or providing an instruction in accordance with the rule), there are presently no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by issuers or insiders, although some issuers and insiders elect to provide disclosure when entering into Rule 10b5-1 plans or conducting transactions under Rule 10b5-1 plans. Further, issuers are not required to disclose information about their insider trading policies or procedures.

The SEC is proposing a new Item 408 under Regulation S-K and corresponding amendments to Forms 10-Q and 10-K to require:

- Quarterly disclosure of the use of Rule 10b5-1 and other trading arrangements by an issuer, and its directors and officers for the trading of the issuer's securities; and
- Annual disclosure of an issuer's insider trading policies and procedures.

The SEC is also proposing new Item 16J to Form 20-F to require annual disclosure of a foreign private issuer's insider trading policies and procedures. In addition, the SEC is proposing amendments to Forms 4 and 5 to require insiders to identify whether a reported transaction was executed pursuant to a Rule 10b5-1(c) trading arrangement.

As proposed, Item 408(a) of Regulation S-K would require issuers to disclose:

Whether, during the issuer's last fiscal quarter (the issuer's fourth fiscal quarter in the case of an annual report), the issuer has adopted or terminated any contract, instruction or written plan to purchase or sell securities of the issuer, whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and provide a description of the material terms of the contract, instruction or written plan, including:

- The date of adoption or termination;
- The duration of the contract, instruction or written plan; and
- The aggregate amount of securities to be sold or purchased pursuant to the contract, instruction or written plan.

And whether, during the issuer's last fiscal quarter, any director or officer has adopted or terminated any contract, instruction or written plan for the purchase or sale of equity securities of the issuer, whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and provide a description of the material terms of the contract, instruction or written plan, including:

- The name and title of the director or officer;
- The date on which the director or officer adopted or terminated the contract instruction or written plan;

- The duration of the contract instruction or written plan; and
- The aggregate number of securities to be sold or purchased pursuant to the contract, instruction or written plan.

Proposed Item 408(b) of Regulation S-K would require issuers to disclose whether the issuer has adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of the issuer's securities by directors, officers, and employees or the issuer itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any listing standards applicable to the issuer. If the issuer has not adopted such insider trading policies and procedures, the issuer must explain why it has not done so, and if the issuer has adopted insider trading policies and procedures, it must disclose such policies and procedures. These disclosures would be required in an issuer's annual reports on Form 10-K and proxy and information statements on Schedules 14A and 14C. Foreign private issuers would also be required to provide analogous disclosure in their annual reports pursuant to a new Item 16J of Form 20-F.

Structured Data Requirements

The SEC is proposing to require that issuers tag the information specified by Item 408 in Inline XBRL in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual. The proposed requirements would include block text tagging of narrative disclosures, as well as detail tagging of quantitative amounts disclosed within the narrative disclosures. In the Proposing Release, the SEC indicates that "[r]equiring Inline XBRL tagging of the disclosures provided pursuant to Item 408 would benefit investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine-readable data language such as ASCII or HTML."

Identification of Rule 10b5-1(c) and Non-Rule 10b5-1(c)(1) Transactions on Forms 4 and 5

In December 2020, the SEC proposed, among other things, amendments to Form 4 and Form 5 to add a checkbox to these forms that would permit filers, at their option, to indicate whether a transaction reported on the form was made pursuant to a contract, instruction, or written trading plan for the purchase or sale of equity securities of the issuer that satisfies the conditions of Rule 10b5-1(c).[5] In the December 2020 Proposing Release, the SEC noted that many Form 4 and Form 5 filers voluntarily provide additional disclosure in these forms stating that a reported transaction satisfied the affirmative defenses conditions of Rule 10b5-1(c). The SEC indicated that the checkbox option would provide filers with a more efficient method to disclose this information.

The SEC is now proposing to add a Rule 10b5-1(c) checkbox as a mandatory disclosure requirement on Forms 4 and 5. This checkbox would require a Form 4 or Form 5 filer to indicate whether a sale or purchase reported on that form was made pursuant to a Rule 10b5-1(c) trading arrangement. Filers would also be required to provide the date of adoption of the Rule 10b5-1 trading arrangement and would have the option to provide additional relevant information about the reported transaction.

In the Proposing Release, the SEC indicates that requiring this disclosure on Forms 4 and 5 would provide greater transparency around the use of Rule 10b5-1 plans and would be consistent with the primary purpose of Exchange Act Section 16 and would provide information that could be used by issuers to comply with their Item 408 disclosure obligations.

In addition, the SEC is proposing to add a second, optional checkbox to both Form 4 and Form 5. This optional checkbox would allow a filer to indicate whether a transaction reported on the form was made pursuant to a pre-planned contract, instruction, or written plan that is not intended to satisfy the conditions of Rule 10b5-1(c).

Disclosure Regarding the Timing of Option Grants

Based on a concern that existing disclosure requirements do not provide investors with adequate information regarding an issuer's policies and practices on stock option awards timed to precede or follow the release of material nonpublic information, the SEC proposes to add a new

paragraph (x) to Item 402 of Regulation S-K that would require tabular disclosure of (i) each option award (including the number of securities underlying the award, the date of grant, the grant date fair value, and the option's exercise price) granted within 14 calendar days before or after the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a Current Report on Form 8-K that contains material nonpublic information; (ii) the market price of the underlying securities on the trading day before disclosure of the material nonpublic information; and (iii) the market price of the underlying securities on the trading day after disclosure of the material nonpublic information. In the Proposing Release, the SEC states that the proposed amendments "are intended to provide shareholders a full and complete picture of any spring-loaded or bullet-dodging option grants during the fiscal year." The SEC also proposes to require that issuers tag the information required by Item 402(x) in Inline XBRL in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual.

Reporting of Gifts on Form 4

Under current requirements, Section 16 reporting persons are required to report any *bona fide* gift of equity securities registered under Exchange Act Section 12 on Form 5. Exchange Act Rule 16a-3(f) provides that every person who, at any time during an issuer's fiscal year, was subject to Section 16 of the Exchange Act must file a Form 5 within 45 days after the issuer's fiscal year end to disclose certain beneficial ownership transactions and holdings not reported previously on Forms 3, 4, or 5. The acquisition and disposition of *bona fide* gifts are eligible for delayed reporting on Form 5 pursuant to Rule 16a-3(f)(1).

In the Proposing Release, the SEC indicates that it has "become aware that the length of the filing period for Form 5 may allow insiders to engage in problematic practices involving gifts of securities, such as insiders making stock gifts while in possession of material nonpublic information, or backdating a stock gift in order to maximize a donor's tax benefit."

The SEC proposes to amend Exchange Act Rule 16a-3 to require the reporting of dispositions of *bona fide* gifts of equity securities on Form 4 before the end of the second business day following the date of execution of the transaction, which would be significantly earlier than what is required under current requirements.

Next Steps

The SEC's proposed amendments are subject to a relatively short comment period of 45 days following publication of the Proposing Release in the Federal Register. We expect that given the priority placed by the SEC on addressing these issues, the SEC will act quickly to consider commenters' suggestions and adopt final rules.

ENDNOTES:

[1]Release No. 33-11013, *Rule 10b5-1 and Insider Trading* (Dec. 15, 2021), *available at* https://www.sec.gov/rules/proposed/2021/33-11013.pdf (the "Proposing Release").

[2]*Opening Remarks Before the 15th Annual NASPP Conference*, Linda Chatman Thomsen (Oct. 10, 2007), *available at* https://www.sec.gov/news/speech/2007/spch101007lct.htm.

[3]*Rulemaking petition regarding Rule 10b5-1 Trading Plans*, File No. 4-658 (Jan. 2, 2013), *available at* https://www.sec.gov/rules/petitions/2013/petn4-658.pdf.

[4]*Recommendations of the Investor Advisory Committee Regarding Rule 10b5-1 Plans*, SEC Investor Advisory Committee (Sept. 9, 2021), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210916-10b5-1- recommendation.pdf .

[5]*Rule 144 Holding Period and Form 144 Filings*, Release No. 33-10991 (Dec. 22, 2020), *available at* https://www.sec.gov/rules/proposed/2020/33-10911.pdf (the "December 2020 Proposing Release").

ISS AND GLASS LEWIS ISSUE VOTING POLICY UPDATES FOR 2022

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Institutional Shareholder Services ("ISS") and Glass, Lewis & Co. ("Glass Lewis"), the two major proxy advisory firms, recently released updates to their proxy voting policies for the 2022 proxy season.[1] The ISS updates will apply for shareholder meetings on or after February 1, 2022, except for those policies subject to a transition period. ISS plans to release an updated Frequently Asked Questions document that will include more information about its policy changes in the coming weeks.[2]

The Glass Lewis updates are included in its 2022 U.S. Policy Guidelines and the 2022 ESG Initiatives Policy Guidelines, which cover shareholder proposals.[3] The Glass Lewis 2022 voting guidelines will apply for shareholder meetings held on or after January 1, 2022.

This article reviews the ISS and Glass Lewis updates. Both firms have announced policy updates on the topics of board diversity, multi-class stock structures, and climate-related management and shareholder proposals. Glass Lewis also issued several policy updates that focus on nominating/governance committee chairs, as well new policies specific to special purpose acquisition companies ("SPACs").

A. Board Diversity

ISS: Racial/Ethnic Diversity. At S&P 1500 and Russell 3000 companies, beginning in 2022, ISS will generally recommend "against" or "withhold" votes for the chair of the nominating/governance committee (or other directors, on a case-by-case basis) if the board "has no apparent racially or ethnically diverse members." This policy was announced in 2020, with a one-year transition. There is an exception for companies where there was at least one racially or ethnically diverse director at the prior annual meeting and the board makes a firm commitment to appoint at least one such director within a year.

ISS: Gender Diversity. ISS announced that, beginning in 2023, it will expand its policy on gender diversity, which since 2020 has applied to S&P 1500 and Russell 3000 companies, to all other companies. Under this policy, ISS generally recommends "against" or "withhold" votes for the chair of the nominating/governance committee (or other directors, on a case-by-case basis) where there are no women on the board. The policy includes an exception analogous to the one in the voting policy on racial/ethnic diversity.

Glass Lewis: Gender Diversity. Beginning in 2022, Glass Lewis will generally recommend "against" or "withhold" votes for the chair of the nominating/governance committee at Russell 3000 companies that do not have at least two gender diverse directors (as announced in connection with its 2021 policy updates), or the entire committee if there is no gender diversity on the board. In 2023, Glass Lewis will move to a percentage-based approach and issue negative voting recommendations for the nominating/governance committee chair if the board is not at least 30% gender diverse. Glass Lewis is using the term "gender diverse" in order to include individuals who identify as non-binary. Glass Lewis also updated its policies to reflect that it will recommend in accordance with mandatory board composition requirements in applicable state laws, whether they relate to gender or other forms of diversity. It will not issue negative voting recommendations for directors where applicable state laws do not mandate board composition requirements, are non-binding, or only impose reporting requirements.

Glass Lewis: Diversity Disclosures. With respect to disclosure about director diversity and skills, for 2021, Glass Lewis had announced that it would begin tracking companies' diversity disclosures in four categories: (1) the percentage of racial/ethnic diversity represented on the board; (2) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity; (3) whether the board has a policy requiring women and other diverse individuals to be part of the director candidate pool; and (4) board skills disclosure. For S&P 500 companies, beginning in 2022, Glass Lewis *may* recommend "against" or "withhold" votes for the chair of the nominating/governance committee if a company fails to provide any disclosure in each of these four categories. Beginning in 2023, it will generally oppose election of the committee chair at S&P 500 companies that have not provided any aggregate or individual disclosure about the racial/ethnic demographics of the board.

B. Companies with Multi-Class Stock or Other Unequal Voting Rights

ISS. ISS announced that, after a one-year transition period, in 2023, it will begin issuing adverse voting recommendations with respect to directors at all U.S. companies with unequal voting rights. Stock with "unequal voting rights" includes multi-class stock structures, as well as less common practices such as maintaining classes of stock that are not entitled to vote on the same ballot items or nominees, and loyalty shares (stock with time-phased voting rights). ISS's policy since 2015 has been to recommend "against" or "withhold" votes for directors of newly-public companies that have multiple classes of stock with unequal voting rights or certain other "poor" governance provisions that are not subject to a reasonable sunset, including classified boards and supermajority voting requirements to amend the governing documents. Companies that were publicly traded before the 2015 policy change, however, were grandfathered and so were not subject to this policy. ISS had sought public comment about whether, in connection with the potential expansion of this policy to all U.S. companies, the policy should apply to all or only some nominees. The final policy does not specify, saying that the adverse voting recommendations may apply to "directors individually, committee members, or the entire board" (except new nominees, who will be evaluated case-by-case). For 2022, the current policy would continue to apply to newly-public companies. ISS tweaked the policy language to reflect that a "newly added reasonable sunset" would prevent negative voting recommendations in subsequent years. ISS considers a sunset period reasonable if it is no more than seven years.

Glass Lewis. Beginning in 2022, Glass Lewis will recommend "against" or "withhold" votes for the chair of the nominating/governance committee at companies that have multi-class share structures with unequal voting rights if they are not subject to a "reasonable" sunset (generally seven years or less).

C. Climate-Related Proposals and Board Accountability at "High-Impact" Companies

ISS: Say on Climate. In 2021, both shareholders and management submitted Say on Climate proposals. For 2022, ISS is adopting voting policies that document the frameworks it has developed for analyzing these proposals, as supplemented by feedback from ISS's 2021 policy development process. Under the new policies, ISS will recommend votes case-by-case on both management and shareholder proposals, taking into consideration a list of factors set forth in each policy. For management proposals asking shareholders to approve a company's climate transition action plan, ISS will focus on "the completeness and rigor of the plan," including the extent to which a company's climate-related disclosures align with Task Force on Climate-related Financial Disclosure ("TCFD") recommendations and other market standards, disclosure of the company's operational and supply chain greenhouse gas ("GHG") emissions (Scopes 1, 2 and 3), and whether the company has made a commitment to be "net zero" for operational and supply chain emissions (Scopes 1, 2 and 3) by 2050. For shareholder proposals requesting Say on Climate votes or other climate-related actions (such as a report outlining a company's GHG emissions levels and reduction targets), ISS will recommend votes case-by-case taking into account information such as the completeness and rigor of a company's climate-related disclosures and the company's actual GHG emissions performance.

ISS: Board Accountability on Climate at High-Impact Companies. ISS also adopted a new policy applicable to companies that are "significant GHG emitters" through their operations or value chain. For 2022, these are companies that Climate Action 100+[4] has identified as disproportionately responsible for GHG emissions. During 2022, ISS will generally recommend "against" or "withhold" votes for the responsible committee chair in cases where ISS determines a company is not taking minimum steps needed to understand, assess and mitigate climate change risks to the company and the larger economy. Expectations about the minimum steps that are sufficient "will increase over time." For 2022, minimum steps are detailed disclosure of climate-related risks (such as according to the TCFD framework") and "appropriate GHG emissions reduction targets," which ISS considers "any well-defined GHG reduction targets." Targets for Scope 3 emissions are not required for 2022, but targets should cover at least a significant portion of the company's direct emissions. For 2022, ISS plans to provide additional data in its voting

analyses on all Climate Action 100+ companies to assist its clients in making voting decisions and in their engagement efforts. As a result of this new policy, companies on the Climate Action 100+ list should be aware that the policy requires **both** disclosure in accordance with a recognized framework, and quantitative GHG reduction targets, and that ISS plans to address its new climate policies in its updated FAQs, so there may be more specifics about this policy when the FAQs are released.

Glass Lewis: Say on Climate. Glass Lewis also added a policy on Say on Climate proposals for 2022 but takes a different approach from ISS. Glass Lewis supports robust disclosure about companies' climate change strategies. However, it has concerns with Say on Climate votes because it views the setting of long-term strategy (which it believes includes climate strategy) as the province of the board and believes shareholders may not have the information necessary to make fully informed voting decisions in this area. In evaluating management proposals asking shareholders to approve a company's climate transition plans, Glass Lewis will evaluate the "governance of the Say on Climate vote" (the board's role in setting strategy in light of the Say on Climate vote, how the board intends to interpret the results of the vote, and the company's engagement efforts with shareholders) and the quality of the plan on a case-by-case basis. Glass Lewis expects companies to clearly identify their climate plans "in a distinct and easily understandable document," which it believes should align with the TCFD framework. Glass Lewis will generally oppose shareholder proposals seeking to approve climate transition plans or to adopt a Say on Climate vote but will take into account the request in the proposal and company-specific factors.

D. Additional ISS Updates

ISS adopted the following additional updates of note:

1. Shareholder Proposals Seeking Racial Equity Audits. ISS adopted a formal policy reflecting its approach to shareholder proposals asking companies to oversee an independent racial equity or civil rights audit. These proposals, which were new for 2021, are expected to return again in 2022 given the continued public focus on issues related to race and equality. ISS will recommend votes case-by-case on these proposals, taking into account several factors listed in its new policy. These factors focus on a company's processes or framework for addressing racial inequity and discrimination internally, its public statements and track record on racial justice, and whether the company's actions are aligned with market norms on civil rights and racial/ethnic diversity.

2. Capital Authorizations. ISS adopted what it characterizes as "minor" and "clarifying" changes to its voting policies on common and preferred stock authorizations. For both policies, ISS will apply the same dilution limits to underperforming companies and will no longer treat companies with total shareholder returns in the bottom 10% of the U.S. market differently. ISS also clarified that problematic uses of capital that would lead to a vote "against" a proposed share increase include long-term poison pills that are not shareholder-approved, rather than just poison pills adopted in the last three years. ISS reorganized the policy on common stock authorizations to distinguish between general and specific uses of capital and to clarify the hierarchy of factors it considers in applying the policy.

3. Three-Year Burn Rate Calculation for Equity Plans. Beginning in 2023, ISS will move to a "Value-Adjusted Burn Rate" in analyzing equity plans. ISS believes this will more accurately measure the value of recently granted equity awards, using a methodology that more precisely measures the value of option grants and calculations that are more readily understood by the market (actual stock price for full-value awards, and the Black-Scholes value for stock options). According to ISS, when the current methodology was adopted, resource limitations prevented it from doing the more extensive calculations needed for the Value-Adjusted Burn Rate.

4. Updated FAQs on ISS Compensation Policies and COVID-19. ISS also issued an updated set of FAQs[5] with guidance on how it intends to approach COVID-19-related pay decisions in conducting its pay-for-performance qualitative evaluation. According to the FAQs, many investors believe that boards are now positioned to return to annual incentive program structures as they existed prior to the pandemic. Accordingly, the FAQs reflect that ISS plans to return to its pre-pandemic approach on mid-year changes

to metrics, targets and measurement periods, and on company responsiveness where a say-on-pay proposal gets less than 70% support.

E. Additional Glass Lewis Updates

Glass Lewis adopted several additional updates, as outlined below. Where relevant, for purposes of comparison, the discussion also addresses how ISS approaches the issue.

1. Waiver of Retirement or Tenure Policies. Glass Lewis appears to be taking a stronger stance on boards that waive their retirement or tenure policies. Beginning in 2022, if the board waives a retirement age or term limit for two or more years in a row, Glass Lewis will generally recommend "against" or "withhold" votes for the nominating/governance committee chair, unless a company provides a "compelling rationale" for the waiver. By way of comparison, ISS does not have an analogous policy.

2. Adoption of Exclusive Forum Clauses Without Shareholder Approval. Under its existing policies, Glass Lewis generally recommends "against" or "withhold" votes for the nominating/governance committee chair at companies that adopted an exclusive forum clause during the past year without shareholder approval. With a growing number of companies adopting exclusive forum clauses that apply to claims under the Securities Act of 1933, Glass Lewis updated its policy to reflect that the policy applies to the adoption of state and/or federal exclusive forum clauses. The existing exception will remain in place for clauses that are "narrowly crafted to suit the particular circumstances" facing a company and/or include a reasonable sunset provision. By way of comparison, ISS does not have an analogous policy.

3. Board Oversight of E&S Issues. For S&P 500 companies, starting in 2022, Glass Lewis will generally recommend "against" or "withhold" votes for the chair of the nominating/governance committee if a company does not provide "explicit disclosure" about the board's role in overseeing environmental and social issues. This policy is taking effect after a transition year in which Glass Lewis noted concerns about disclosures it did not view as adequate. For 2022, Glass Lewis also will take the same approach for Russell 1000 companies that it took last year with S&P 500 companies, noting a concern where there is a lack of "clear disclosure" about which committees or directors are charged with oversight of E&S issues. Glass Lewis does not express a preference for a particular oversight structure, stating that boards should select the structure they believe is best for them.

4. Independence Standard on Direct Payments for Directors. In evaluating director independence, Glass Lewis treats a director as not independent if the director is paid to perform services for the company (other than serving on the board) and the payments exceed $50,000 or no amount is disclosed. Glass Lewis clarified that this standard also captures payments to firms where a director is the principal or majority owner. By way of comparison, ISS's independence standards likewise cover situations where a director is a partner or controlling shareholder in an entity that has business relationships with the company in excess of numerical thresholds used by ISS.

5. Approach to Committee Chairs at Companies with Classified Boards. A number of Glass Lewis' voting policies focus on committee chairs because it believes the chair has "primary responsibility" for a committee's actions. Currently, if Glass Lewis policies would lead to a negative voting recommendation for a committee chair, but the chair is not up for election because the board is classified, Glass Lewis notes a concern with respect to the chair in its proxy voting analysis. Beginning in 2022, this policy will change and if Glass Lewis has identified "multiple concerns," it will generally issue (on a case-by-case basis) negative voting recommendations for other committee members who are up for election.

6. Written Consent Shareholder Proposals. Glass Lewis documented its approach to shareholder proposals asking companies to lower the ownership threshold required for shareholders to act by written consent. It will generally recommend in favor of these proposals if a company has no special meeting right or the special meeting ownership threshold is over 15%. Glass Lewis will continue its existing policy of opposing proposals to adopt written consent if a company has a special meeting threshold of 15% or lower and "reasonable" proxy access provisions. By way of comparison, ISS generally supports

proposals to adopt written consent, taking into account a variety of factors including the ownership threshold. It will recommend votes case-by-case only if a company has an "unfettered" special meeting right with a 10% ownership threshold and other "good" governance practices, including majority voting in uncontested director elections and an annually elected board.

7. SPAC Governance. Glass Lewis added voting guidelines that are specific to the SPAC context. When evaluating companies that have gone public through a de-SPAC transaction during the past year, it will review their governance practices to assess "whether shareholder rights are being severely restricted indefinitely" and whether restrictive provisions were submitted to an advisory vote at the meeting where shareholders voted on the de-SPAC transaction. If the board adopted certain practices prior to the transaction (such as a multi-class stock structure or a poison pill, classified board or other anti-takeover device), Glass Lewis will generally recommend "against" or "withhold" votes for all directors who served at the time the de-SPAC entity became publicly traded if the board: (a) did not also submit these provisions for a shareholder advisory vote at the meeting where the shareholders voted on the de-SPAC transaction; or (b) did not also commit to submitting the provisions for shareholder approval at the company's first annual meeting after the de-SPAC transaction; or (c) did not also provide for a reasonable sunset (three to five years for a poison pill or classified board and seven years or less for multi-class stock structures). By way of comparison, as discussed above, for several years, ISS has had voting policies that address "poor" governance provisions at newly-public companies, including multiple classes of stock with unequal voting rights, classified boards and supermajority voting requirements to amend the governing documents. For 2022, ISS has clarified that the definition of "newly-public companies" includes SPACs.

8. "Overboarding" and SPAC Board Seats. Under its "overboarding" policies, Glass Lewis generally recommends "against" or "withhold" votes for directors who are public company executives if they serve on a total of more than two public company boards. It applies a higher limit of five public company boards for other directors. The 2022 policy updates clarify that where a director's only executive role is at a SPAC, the higher limit will apply. By way of comparison, ISS treats SPAC CEOs the same as other public company CEOs, on the grounds that a SPAC CEO "has a time-consuming job: to find a suitable target and consummate a transaction within a limited time period." Accordingly, SPAC CEOs are subject to the same overboarding limit ISS applies to other public company CEOs (two public company boards besides their own).

ENDNOTES:

[1]The ISS U.S. policy updates are available at: https://www.issgovernance.com/file/policy/latest/updates/Americas-Policy-Updates.pdf.

[2]ISS also issued an updated set of FAQs on COVID-19-related compensation decisions.

[3]Both documents are available at: https://www.glasslewis.com/voting-policies-upcoming/.

[4] https://www.climateaction100.org/whos-involved/companies/.

[5]Available here: https://www.issgovernance.com/file/policy/latest/americas/US-Compensation-Policies-and-the-COVID-19-Pandemic.pdf.

AS U.S. TREASURY PROPOSES BENEFICIAL OWNERSHIP REPORTING RULE, OUTREACH UNDERWAY TO DETERMINE DATA ACCESS

By Brett Wolf

Brett Wolf is Senior Financial Crime Correspondent for Thomson Reuters Regulatory Intelligence, based in St. Louis.

Millions of corporations, limited liability companies and other entities would be required to report their true, or "beneficial" owners to the U.S. Treasury Department for inclusion in a government database, or registry, aimed at helping authorities combat financial crimes under a Treasury rule proposed on December 14, 2021.

Meanwhile, Treasury's Financial Crimes Enforcement Network ("FinCEN")—the bureau Congress tasked with

drafting rules pursuant to the Corporate Transparency Act ("CTA")—is in contact with "stakeholders"—as it works to make a much-anticipated decision about who should be able to access the registry.

FinCEN will make public its position on access to the registry in a separate proposed rule, or Notice of Proposed Rulemaking ("NPRM"), "at a later date," FinCEN spokeswoman Jayna Desai said, in an emailed response to a query from Thomson Reuters Regulatory Intelligence.

"We are diligently working on the access rule and conducting outreach to stakeholders as we work in parallel to develop an NPRM on access protocols," Desai said.

At issue is whether, and to what degree, financial institutions may have access to the information contained in the registry once FinCEN creates the database and begins collecting legal entity ownership data aimed at lifting the corporate veil that has historically allowed criminals to hide ownership of assets.

The 188-page FinCEN proposed rule[1] made public in mid-December brings the bureau one step closer to deciding precisely which entities will be required to report to the government.

"The proposed rule for beneficial ownership reporting is a major step toward addressing the gaps in our corporate transparency framework that allow corruption to flourish and illicit funds to flow into the United States," Treasury Secretary Janet Yellen said in a written statement.

Treasury already has released a new anti-corruption strategy, issued a number of sanctions targeting allegedly corrupt individuals around the world and begun a rulemaking process aimed at extending anti-money laundering ("AML") rules to parties in all-cash real estate transactions.

This flurry of activity occurred as President Joe Biden hosted the virtual U.S. Summit for Democracy, which is reportedly aimed at helping stop democratic backsliding and the erosion of rights and freedoms worldwide.

Washington's anti-corruption push comes after a series of leaked documents scandals, including last October's release of the Pandora Papers, raised questions about ways in which government officials and others discreetly move money abroad, potentially to dodge taxes or accountability for wrongdoing.

Proposed Rule on Beneficial Ownership Reporting

FinCEN's proposed beneficial ownership reporting rule would require companies to file reports that identify two categories of people: the beneficial owners of entities and individuals who have filed applications with specified governmental or tribal authorities to form entities or register them to do business.

Both foreign and domestic entities would have reporting obligations and corporations and LLCs would be covered, as would limited liability partnerships, business trusts, and most limited partnerships, "because such entities appear typically to be created by a filing with a secretary of state or similar office," FinCEN said in a "fact sheet" issued in conjunction with the proposed rule.[2]

It added, however, that "under the proposed rule and in keeping with the CTA, 23 types of entities would be exempt from the definition of 'reporting company.' " And other entities, including certain trusts, "would appear to be excluded from the definitions to the extent that they are not created by the filing of a document with a secretary of state or similar office."

Financial institutions already are required to collect beneficial ownership from customers pursuant to FinCEN's customer due diligence ("CDD") rule, which came into force in 2018. At AML conferences and other events held since the CTA was enacted on January 1, 2021, bankers and others have been nervously discussing the potential impact of the CTA on the CDD rule.

While many initially thought the new law might lessen their compliance burden, such optimism has largely yielded to worries that various reporting exemptions, a lack of access to the registry, and other factors could, in fact, make matters worse.

They are eager to know whether, and to what degree, financial institutions will be able to access the information held in the registry—even indirectly, such as with FinCEN

handling information requests—so that they can verify information submitted by customers.

The CTA states that once FinCEN issues a final rule outlining which legal entities must report beneficial ownership to the registry, the Treasury bureau will have one year to revise the banking industry CDD rule to take the new situation into account.

"FinCEN looks forward to soliciting public comment on these efforts in the context of forthcoming rulemaking processes," said FinCEN's Desai.

ENDNOTES:

[1] https://www.federalregister.gov/documents/2021/12/08/2021-26548/beneficial-ownership-information-reporting-requirements.

[2] https://www.fincen.gov/news/news-releases/fact-sheet-beneficial-ownership-information-reporting-notice-proposed-rulemaking.

REINFORCING THE ATTRACTIVENESS OF FRENCH START-UPS: BSPCE, AN INCENTIVE TOOL NOW AVAILABLE TO FOREIGN COMPANIES

By Olivia Lê Horovitz and Nicolas Simon

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The *bons de souscription de parts de créateurs d'entreprise* ("BSPCE") are a category of securities under French law which entitle their holders to subscribe shares of the issuing company during a specific period and at a price fixed during the allocation decision, and which may be granted by young innovative companies to recruit and retain their employees and executive officers (or those of their subsidiaries).

These securities are particularly advantageous from a tax standpoint for the employee, but also for the issuing company and have been used by French start-ups for many years.

French Law No. 2019-1479 of December 28, 2019 of the Finance Act for 2020, added an Article III bis to Article 163 bis G of the French General Tax Code to indicate that all of the provisions on the issuance of BSPCE "*shall apply to BSPCE granted, under the same conditions, by a company whose registered office is established in a Member State of the European Union or in a State or territory that has concluded with France a tax treaty containing an administrative assistance clause to combat tax evasion or avoidance*."

The French government wants to strengthen the attractiveness of France by encouraging young innovative foreign companies to establish subsidiaries in France and hire French employees, especially in the context of Brexit and the internationalization of France's innovative ecosystem. Employees of start-ups with BSPCE will also now be able to benefit from a discount on the exercise price of their warrants compared to the acquisition price paid by investors during the company's last fundraising. The financial conditions will thus be more favorable for employees, a key element in attracting and retaining them in a context of strong recruitment tensions.

The countries benefiting from these provisions are numerous and include Germany, the United States, Australia, the United Arab Emirates, and the United Kingdom.

Thus, BSPCE is now an international tool. A foreign company, provided it meets the requirements under French law, may itself issue BSPCE to its employees or managers located in France (or the employees or managers of its French subsidiaries).

However, this internationalization of BSPCE causes some practical legal problems for which we do not yet have all the answers. Compliance with the conditions and in particular, with the issuance procedure designed for French companies, may be difficult to impose on foreign companies.

Tax authorities have provided clarification on the subject through an update in February 2021.

First, not all companies can issue BSPCE. Those that can must have similar characteristics to eligible companies under French law (*i.e.*, joint-stock companies). In addition, the foreign company shall:

- be liable to a tax equivalent to French corporate income tax in the country or territory where its registered office is located;
- be directly and continuously held for at least 25% by natural persons;
- have been registered in a register equivalent to the French Trade and Companies Register for less than 15 years;
- have a market capitalization of less than 150 million euros; and
- not be created in the context of a merger, restructuring, expansion or takeover of pre-existing activities.

These conditions are easily understandable. However, it is more complicated to strictly comply with the procedure applicable to French companies for the issuance of BSPCE.

Indeed, the French General Tax Code provides a specific procedure for French companies for the issuance of BSPCE (extraordinary general meeting of shareholders, delegation of powers to the Board of Directors, mandatory reports to be drafted) which cannot, in practice, be strictly complied with by foreign companies. For example, in a given jurisdiction, the competent body to decide on such issuance may not be the shareholders.

The tax authorities have provided few details on how to adapt the issuance procedure, indicating only that the French procedure is applicable to the issuance of BSPCE by a foreign company and that "*the corporate bodies empowered to authorize the granting of BSPCE and to set their terms and conditions, as well as the corporate bodies delegated with such powers, may be adapted to take into account the regulation applicable to the foreign company. The provisions concerning these bodies may therefore, for foreign companies, apply to authorized bodies equivalent to those designated for French companies.*"

The administration adds that the provisions relating to the time limits for exercising the BSPCE or the methods for determining the purchase price, (price freely fixed except in the event of a capital increase of the issuing company during the last six months), of the shares subscribed to in the exercise of the BSPCE shall be complied with.

No further information is given on how to proceed with an issuance of BSPCE by a foreign company, and there is as a result, some uncertainty as to how it should be carried out.

However, it is possible to usefully refer to the clarifications provided by the French administration on international stock option issuance, even if they do not answer all the practical questions.

In any event, it is recommended that foreign companies state in their various legal documents their intention to treat their issuances as an issuance of BSPCE and indicate the adjustments that have been necessary in relation to the provisions of French law in order to comply with local law.

It is hoped that clarification will soon be provided by French tax authorities and that it will not be necessary to wait for the first foreign BSPCE to be exercised before the doctrine is clarified in light of litigation.

We have already proceeded with the issuance of BSPCE for foreign companies with a French subsidiary and trust that more and more start-up companies will be looking at implementing such an interesting incentive for their employees.

ON REDUCING THE POTENTIAL RISKS OF SPACs

By Gary Gensler

Gary Gensler is Chair of the Securities and Exchange Commission. The following is edited and adapted from remarks that he gave at the Healthy Markets Association Conference on December 9, 2021.

I'd like to start by discussing an overarching principle I consider when thinking about public policy. This principle has been around since at least antiquity. Aristotle captured it with his famous maxim: Treat like cases alike.[1] This was as true two thousand years ago as it is in 2001.

Finance is constantly evolving in response to new technologies and new business models. Such innovation can bring greater access, competition, and growth to our capital markets and our economy. Our central question is this, though: When new vehicles and technologies come along, how do we continue to achieve our core public policy goals? How do we ensure that like activities are treated alike?

Today, I'd like to discuss one such innovation. It relates to a method by which companies go public: special purpose acquisition companies, or SPACs. While not new—the first SPAC was filed in 2003[2]—SPACs really have taken off in the last couple of years.

In 2020, Healthy Markets Association executive director Tyler Gellasch [was] quoted as saying that SPACs are "fraught with peril for investors."[3] I first testified about SPACs in May,[4] and this issue has been on the SEC's Agency Rule List since June.[5]

SPACs present an alternative method to go public from traditional IPOs. Unlike those conventional IPOs, however, there are two main stages in a SPAC. There also are more players competing for a piece of the pie than there are in traditional IPOs. There are a lot of moving parts, and a lot of novel aspects to these vehicles.

First, blank-check companies raise cash from the public through initial public offerings. I call this step the "SPAC blank-check IPO." The number of SPAC blank-check IPOs has ballooned by nearly 10 times between 2019 and 2021. Further, those SPAC blank-check IPOs now account for more than three-fifths of all U.S. IPOs.[6]

Typically, the blank-check company has up to two years to search for and merge with a target company.

Once SPAC sponsors find a target company, they often raise additional capital through transactions known as private investments in public equity, or "PIPEs." These deals give new investors—mostly large institutions—an opportunity to put money into the SPAC target IPO. Then, through the merger, the target company goes public. If a deal is approved, the initial shareholders are provided a redemption right to cash out—redeeming at the blank-check IPO price.

Some call that second step, the merger process, the "de-SPAC." I like to call it the "SPAC target IPO."

In 2021, there were 181 such SPAC target IPOs, with a total deal value of $370 billion.[7]

This is up from just 26 SPAC target IPOs as recently as 2019. As the figures show, many private companies now consider SPAC target IPOs as a competitive method to access the public markets.

How should this competitive market innovation be treated under our public policy framework? If Aristotle were around, I think he'd say you shouldn't be able to arbitrage the rules. So, with regard to companies raising money from the public, which principles and tools do we use to ensure that like activities are treated alike?

Public Policy Principles

Let's go back in time again—this time, about a century.

In the early 1900s, a Kansas banking regulator named Joseph Norman Dolley laid out some basic tenets. Depositors in his state were taking money out of the bank accounts to buy securities from bad-faith actors in Kansas, and many of these investors were getting flimflammed.

Thus, Mr. Dolley helped advocate for the first blue-sky laws in 1911.[8] These laws required all securities to be registered with the state. Brokers who were selling these securities had to register, too.

A couple of decades later, in the depths of the Great Depression, the federal government decided it was time to provide investors with federal-level protections. Therefore, Congress and Franklin Delano Roosevelt crafted the Securities Act of 1933 and the Securities Exchange Act of 1934.

With these foundational laws, Mr. Dolley, Congress, and FDR addressed three core, interrelated principles.

First, leveling out ***information asymmetries***. Companies and managers have access to information that the buying public doesn't necessarily have. Thus, one of Congress's goals was to level out some of those information asymmetries.

Second, guarding against ***misleading information and***

fraud. There's a reason President Roosevelt called the 1933 Act the "Truth in Securities" law. To guard against fraud and abusive, high-pressure sales tactics, he thought it was important to have standards for how and when companies would provide important information to the public, and what the substance of that information would be.

Third, mitigating ***conflicts***. This is what economists might call "agency costs"—the idea that various parties to a deal, from management to brokers, may have different incentives than investors when it comes to buying and selling stock. These misaligned incentives and conflicts might enrich certain parties at the expense of others.

These principles addressed in the context of the 1930s all three parts of our mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Building trust in our capital markets is as important to those raising money as it is to those investing their money.

Policy Tools for Public Offerings

What tools did Congress and FDR come up with to mitigate these concerns?

First, companies raising money from the public should provide full and fair ***disclosure*** to investors at the time they're making their crucial decisions to invest. This isn't just about quality, quantity, and substance of disclosure, but also the timing.

Second, and relatedly, is standards around ***marketing practices***. The idea is that parties to the transaction shouldn't use sales tactics that would "condition the market" before the required disclosure reaches investors.

Third is ***gatekeeper obligations***. The third parties involved in the sale of the securities—such as auditors, brokers, and underwriters—should have to stand behind and be responsible for basic aspects of their work. Thus, gatekeepers provide an essential function to police fraud and ensure the accuracy of disclosure to investors.

Fourth, of course, Congress also felt there needed to be a federal ***cop on the beat***—the SEC—to help ensure that the rules are met.

SPACs

This brings me back to SPACs. SPACs raise a number of questions, in my view.

Are SPAC investors—both at the time of the initial SPAC blank-check IPO and during the SPAC target IPO—benefiting from the protections they would get in traditional IPOs, with respect to disclosure, marketing practices, and gatekeepers? In other words, are like cases being treated alike?

Currently, I believe the investing public may not be getting like protections between traditional IPOs and SPACs. Further, are we mitigating the information asymmetries, fraud, and conflicts as best we can?

Due to the various moving parts and SPACs' two-step structure, I believe these vehicles may have additional conflicts inherent to their structure. There are conflicts between the investors who vote then cash out, and those who stay through the deal—what might be called "redeemers" and "remainers."

Thus, to reduce the potential for such information asymmetries, conflicts, and fraud, I've asked staff for proposals for the Commission's consideration around how to better align the legal treatment of SPACs and their participants with the investor protections provided in other IPOs, with respect to disclosure, marketing practices, and gatekeeper obligations.

Disclosure

There is inconsistent and differential disclosure among the various parties involved in SPACs transactions—both the SPAC blank-check IPO and the SPAC target IPO. For example, PIPE investors may gain access to information the public hasn't seen yet, at different times, and can buy discounted shares based upon that information. That's among other benefits.

What's more, retail investors may not be getting adequate information about how their shares can be diluted throughout the various stages of a SPAC.

For instance, SPAC sponsors generally get to pocket 20% of the equity—but *only* if they actually complete a

deal later. This dilution largely falls on the "remainers," not those who cash out after the vote.

Thus, I've asked staff to serve up recommendations about how investors might be better informed about the fees, projections, dilution, and conflicts that may exist during all stages of SPACs, and how investors can receive those disclosures at the time they're deciding whether to invest. I've also asked staff to consider clarifying disclosure obligations under existing rules.

Marketing Practices

Next, I'd like to turn to marketing practices. SPAC target IPOs often are announced with a slide deck, a press release, and even celebrity endorsements. The value of SPAC shares can move dramatically based on incomplete information, long before a full disclosure document or proxy is filed.

Thus, SPAC sponsors may be priming the market without providing robust disclosures to the public to back up their claims. Investors may be making decisions based on incomplete information or just plain old hype.

It is essential that investors receive the information they need, when they need it, without misleading hype. Therefore, I've asked staff to make recommendations around how to guard against what effectively may be improper conditioning of the SPAC target IPO market. This could, for example, include providing more complete information at the time that a SPAC target IPO is announced.

Gatekeeper Obligations

Next, as SPAC target IPOs occur through a merger, who's performing the role of gatekeepers: potentially including directors, officers, SPAC sponsors, financial advisors, and accountants?

In traditional IPOs, issuers usually work with investment banks. Thus, a lot of people think the term "underwriters" solely refers to investment banks. The law, though, takes a broader view of who constitutes an underwriter.

There may be some who attempt to use SPACs as a way to arbitrage liability regimes. Many gatekeepers carry out functionally the same role as they would in a traditional IPO but may not be performing the due diligence that we've come to expect. Make no mistake: When it comes to liability, SPACs do not provide a "free pass" for gatekeepers.

As John Coates, then-Acting Director of the Division of Corporation Finance, said in March, "Any simple claim about reduced liability exposure for SPAC participants is overstated at best, and potentially seriously misleading at worst."[9]

Therefore, I've asked staff for recommendations about how we can better align incentives between gatekeepers and investors, and how we can address the status of gatekeepers' liability obligations.

Cop on the Beat

As we evaluate these policy areas, our Division of Enforcement continues to be the cop on the beat to ensure that investors are being protected in the SPAC space. For example, we recently charged a SPAC, its proposed merger target, and others ahead of the deal in a case that highlighted the risks inherent to SPAC transactions.[10] I've asked our Enforcement Division to continue to take all appropriate action, following the facts and the law, to protect investors in these vehicles.

Conclusion

Ultimately, I think it's important to consider the economic drivers of SPACs.

Functionally, the SPAC target IPO is akin to a traditional IPO. Thus, investors deserve the protections they receive from traditional IPOs, with respect to information asymmetries, fraud, and conflicts, and when it comes to disclosure, marketing practices, and gatekeepers.

In keeping with our three-part mission, we are always thinking about ways to promote efficiency in traditional IPOs. I think that these innovations around SPAC target IPOs remind us that there may be room for improvements in traditional IPOs as well. Broadly, though, the 1933 Act protections have stood the test of time.

We're not in Kansas anymore . . . or for that matter, in Ancient Greece. And yet, as Aristotle might say, no matter when or where, like should be treated alike.

ENDNOTES:

[1]*See* Benjamin Johnson and Richard Jordan, "Why Should Like Cases Be Decided Alike? A Formal Model of Aristotelian Justice" (March 1, 2017), available at https://scholar.princeton.edu/sites/default/files/benjohnson/files/like_cases.pdf.

[2]*See* Usha Rodrigues and Michael A. Stegemoller, "SPACs: Insider IPOs" (2021), *available at* SSRN: https://ssrn.com/abstract=3906196orhttp://dx.doi.org/10.2139/ssrn.3906196.

[3]*See* "SPAC IPOs Surge," available at https://www.gfmag.com/magazine/december-2020/spac-ipos-surge.

[4]*See* "Testimony Before the Subcommittee on Financial Services and General Government, U.S. House Appropriations Committee" (May 26, 2021), available at https://www.sec.gov/news/testimony/gensler-2021-05-26.

[5]*See* "Agency Rule List-Spring 2021," *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B70868F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F.

[6]*See* SPAC Analytics, *available at* https://spacanalytics.com/.

[7]*See* US SPACs Data Hub, *available at* https://www.whitecase.com/publications/insight/us-spacs-data-hub.

[8]*See* "Kansas Blue Sky Laws," *available at* https://www.kshs.org/kansapedia/kansas-blue-sky-laws/18618.

[9]*See* "SPACs, IPOs and Liability Risk under the Securities Laws," *available at* https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws. Citations omitted. This staff statement, like all staff statements, has no legal force or effect; it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

[10]*See* "SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination" (July 13, 2021), *available at* https://www.sec.gov/news/press-release/2021-124.

SEC/SRO UPDATE: SEC PROPOSES AMENDMENTS TO MONEY MARKET FUND RULES; SEC ISSUES ACCOUNTING GUIDANCE ON "SPRING-LOADED" COMPENSATION; SEC CHARGES PHARMA CFO & FORMER PARTNER WITH INSIDER TRADING; SEC NAMES TOP OFFICIALS IN TRADING, MUNICIPALS; SEC ADOPTS FINAL AMENDMENTS TO RULES IMPLEMENTING HFCAA; PROPOSED RULE TO STRENGTHEN SECURITIES LENDING MARKET TRANSPARENCY

SEC Proposes Amendments to Money Market Fund Rules

On Dec. 15, 2021, the Securities and Exchange Commission voted to propose amendments to rules that govern money market funds under the Investment Company Act of 1940.[1] The SEC said these proposed amendments were crafted in response to concerns about the health of prime and tax-exempt money market funds in adverse market conditions.

When the COVID-19 pandemic hit the U.S. in earnest in March 2020, many wary investors piled their assets into cash and short-term government securities. This led to large outflows in prime and tax-exempt money market

funds, particularly institutional funds, which in turn put heavy stress on short-term funding markets in spring 2020.

The proposed amendments would thus increase liquidity requirements for money market funds to provide a more substantial liquidity buffer should similar rapid redemptions occur in the future. Further, they would remove provisions in the current rule permitting or requiring a money market fund to impose liquidity fees or to suspend redemptions through a gate when a fund's liquidity drops below an identified threshold. The SEC claimed such provisions "appeared to contribute to investors' incentives to redeem in March 2020 as some funds' reported liquidity levels declined."

"Together, these amendments are designed to reduce the likelihood of runs on money market funds during periods of stress," said SEC Chair Gary Gensler in a statement. "They also would equip funds to better meet large redemptions, addressing concerns about redemption costs and liquidity. Given the broad reach of short-term funding markets, these proposals speak to our remit to maintain fair, orderly, and efficient markets."

Seeking to address concerns about redemption costs and liquidity, the proposed amendments would require institutional prime and tax-exempt money market funds to implement swing pricing policies and procedures that would require redeeming investors, under certain circumstances, to bear the liquidity costs of their redemptions.

Further, the SEC would amend certain reporting requirements to increase available and accessible information about money market funds and thus enhance its monitoring and analysis of said funds.

The proposed amendments stem from a request for comment the SEC issued for public feedback on potential money market fund reforms, including reform options that were discussed in a December 2020 report of the President's Working Group on Financial Markets. The proposal will be published on SEC.gov and in the Federal Register. The comment period will remain open for 60 days after publication in the latter.

SEC Issues Accounting Guidance on "Spring-Loaded" Executive Compensation Awards

On November 29, the SEC released guidance for companies on how to properly recognize and disclose compensation costs for "spring-loaded" incentive awards made to executives.[2]

"Spring-loaded" awards are share-based compensation arrangements (including stock options and other stock-based awards) that are typically granted shortly before the company announces information that could positively affect its stock price, such as an earnings release with better-than-expected results or announcing an acquisition, for example. Many companies intentionally schedule their equity grants to be made following the public release of financial and other material information to avoid such "spring-loading" allegations.

As per Staff Accounting Bulletin ("SAB") No. 120, prepared by the SEC's Office of the Chief Accountant and the Division of Corporation Finance, the SEC claims that "non-routine spring-loaded grants merit particular scrutiny by those responsible for compensation and financial reporting governance at public companies . . . SEC staff believes that as companies measure compensation actually paid to executives, they must consider the impact that the material nonpublic information will have upon release."

Essentially, as per the SEC, companies should not grant spring-loaded awards by mistakenly believing that they don't have to reflect additional value conveyed to the recipients from the anticipated announcement of material information when recognizing compensation cost for the awards. "It is important that companies' accounting and disclosures reflect the economics and terms of these compensation arrangements," SEC Chair Gary Gensler said. "This gets to the SEC's remit to protect investors."

The SEC noted that "the statements in SABs are not rules or interpretations of the Commission nor are they published bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws."

This guidance has implications for several areas, including the size of grants, the expensing of awards for financial statement purposes, and in financial statement disclosures. For the latter, SEC guidance states that if an issuer is required to make an adjustment to the share price used to estimate the grant date fair value of "spring-loaded" incentive awards, they must also disclose how they determined the amount of the adjustment and how these awards differ from other share-based awards the issuer has granted. Such disclosures could lead to increased scrutiny from the likes of ISS and Glass Lewis as well as plaintiffs' counsels.

The new guidance may also require issuers to revise existing disclosure controls and procedures so as to properly identify any potential positive material nonpublic information and ensure that it is appropriately communicated, in order to avoid the inadvertent creation of "spring-loaded" incentive awards.

SEC Charges Pharma CFO and Former Partner with Insider Trading

On December 2, 2021, the SEC charged the former Chief Financial Officer of pharmaceutical company Immunomedics, Inc. and his former romantic partner with insider trading in the company's stock.

According to the SEC's complaint,[3] while serving as CFO of Immunomedics, Usama Malik discovered that the FDA had permitted the company to halt a clinical trial for a breast cancer drug because the existing trial data provided compelling evidence that the drug was effective.

As per the complaint, Malik, who was subject to a trading "black-out" that prohibited him and anyone in his household from purchasing Immunomedics stock at the time, allegedly tipped Lauren S. Wood, with whom he then lived, as well as three family members. The SEC alleges that Wood and two family members soon bought Immunomedics stock, as did an account in the name of the third family member's spouse. After Immunomedics announced the FDA's decision, its stock price nearly doubled, resulting in a gain of $67,060 to Wood and a combined gain of approximately $21,000 to the family members, as per the SEC.

The complaint further alleges that when Malik was queried about Wood's trading, as part of an inquiry by the Financial Industry Regulatory Authority, he failed to identify her as his romantic partner and falsely claimed that he had not communicated with her during the relevant period.

The SEC's complaint, filed in the U.S. District Court for the District of New Jersey, charges Malik and Wood with violating antifraud provisions of the federal securities laws. The Commission seeks against each of them a permanent injunction and civil penalty and, against Malik, an officer and director bar. In a parallel action, the U.S. Attorney's Office for the District of Jersey has announced criminal charges against Malik and Wood.

SEC Names Top Officials in Trading, Municipals, Public Finance Abuse

Effective December 10, the SEC appointed **Haoxiang Zhu**, a professor of finance at the Massachusetts Institute of Technology, as Director of its Division of Trading and Markets.

Zhu is the Gordon Y. Billard Professor of Management and Finance and Associate Professor of Finance at the MIT Sloan School of Management. He also serves as a Research Associate at the National Bureau of Economic Research, Finance Department Editor at Management Science, and Associate Editor at the Journal of Finance. He has worked for the Commodity Futures Trading Commission and the Bank for International Settlements and as a member of the Federal Reserve Bank of Chicago's Working Group on Financial Markets. He has a BA in mathematics and computer science from the University of Oxford and a PhD in finance from Stanford University Graduate School of Business.

"At the center of the SEC's three-part mission is maintaining fair, orderly, and efficient capital markets," said SEC Chair Gary Gensler. "The work of our Division of Trading and Markets links the investors in our capital markets with those companies seeking to raise money, hire employees, and grow. Haoxiang brings to the SEC deep expertise and commitment to the agency's efforts to enhance and update our rules to continue to maintain markets that are the envy in the world."

David Saltiel, who served as Acting Director of the Division during much of 2021, was appointed as one of the Division's Deputy Directors. He also will continue to lead the Office of Analytics and Research, a role he has held since 2016. Prior to joining the SEC, Saltiel was chief economist at the Municipal Securities Rulemaking Board. He is a graduate of Williams College and earned his master's degree in economics from St. Antony's College at the University of Oxford.

On December 3, **Ernesto Lanza** was announced as acting director of the Office of Municipal Securities ("OMS").[4] Lanza has served as Senior Counsel to the OMS Director since 2019. Prior to joining the SEC, Lanza was in private practice, focusing on public finance matters related to securities law, disclosure, and market structure issues. He previously served as the Deputy Executive Director of the Municipal Securities Rulemaking Board, where he led a number of policy initiatives, including the launch of the EMMA system. Before that, he was the MSRB's Chief Legal Officer and General Counsel.

Lanza replaces **Rebecca Olsen**, who was named Deputy Chief for the Division of Enforcement's Public Finance Abuse ("PFA") Unit. Olsen became head of OMS in September 2018 and had previously served as the Office's Deputy Director, Chief Counsel, and attorney fellow.

And in turn Olsen will replace **Mark Zehner**, who has held the PFA role since July 2010 and is now retiring from the agency. Zehner joined the SEC in January 1997. Prior to joining the Enforcement Division, he served as Regional Municipal Securities Counsel in the SEC's Philadelphia Regional Office and as an Attorney-Fellow in OMS.

SEC Adopts Final Amendments to Rules Implementing HFCAA

On Dec. 2, the SEC adopted final amendments to its rules implementing the Holding Foreign Companies Accountable Act of 2020 ("HFCAA").[5]

The amendments finalize interim final rules that the Commission had adopted in March 2021, which had addressed the submission and disclosure requirements of the HFCAA, with two modifications. First, they clarify how the requirements apply to variable interest entities. Second, they include requirements to tag information such as auditor name and location. The final amendments also establish procedures the Commission will follow in identifying issuers and prohibiting trading by certain issuers under the HFCAA.

"We have a basic bargain in our securities regime, which came out of Congress on a bipartisan basis under the Sarbanes-Oxley Act of 2002," Chair Gensler said in a statement. "If you want to issue public securities in the U.S., the firms that audit your books have to be subject to inspection by the Public Company Accounting Oversight Board ("PCAOB")." While more than 50 jurisdictions have worked with the PCAOB to allow the required inspections, two historically have not: China and Hong Kong.

"[In 2020] once again on a bipartisan basis—Congress said that it's time for audit firms in all jurisdictions around the world to comply fully with Sarbanes-Oxley. The HFCAA mandated that, if governmental authorities don't allow the auditors of foreign companies to open their work papers to PCAOB inspection for three consecutive years, the securities of companies audited by those firms could be prohibited from trading in the U.S."

The finalized rules will, as per the SEC, enable investors to easily identify registrants whose auditing firms are located in a foreign jurisdiction that the PCAOB cannot completely inspect. Foreign issuers also will be required to disclose the level of foreign government ownership in those entities.

Proposed Rule to Strengthen Securities Lending Market Transparency

The Securities and Exchange Commission on November 18 published proposed Exchange Act Rule 10c-1,[6] which would require lenders of securities to provide material terms of securities lending transactions to a registered national securities association, such as the Financial Industry Regulatory Authority. The registered national securities association would then make the material terms of the securities lending transaction available to the public.

Under the proposed rule, data concerning securities lending transactions would be reported to a registered national securities association within 15 minutes. Further,

at the end of each business day, lenders would be required to report the number of shares of each security they have lent out, as well as the number of shares available to borrow.

"Securities lending and borrowing is an important part of our market structure. Currently, though, the securities lending market is opaque," said SEC Chair Gary Gensler in a statement. "Although private data vendors collect and sell some lending data, this information is incomplete, as not all market participants choose to participate. Market participants have had to pay to subscribe to multiple feeds to access even the limited data available. Together, this results in information asymmetries between borrowers and lenders, creating inefficiencies in this market . . . It's important that market participants have access to fair, accurate, and timely information. I believe this proposal would bring securities lending out of the dark."

The SEC claimed its proposed rule is consistent with Congress's mandate in the Dodd-Frank Act that the Commission "should increase transparency regarding the loan or borrowing of securities for brokers, dealers, and investors by ensuring that market participants, the public, and regulators have access to timely and comprehensive information about the market for securities lending."

ENDNOTES:

[1] *See* https://www.sec.gov/news/press-release/2021-258.

[2] *See*: https://www.sec.gov/news/press-release/2021-246.

[3] https://www.sec.gov/news/press-release/2021-249.

[4] *See*: https://www.sec.gov/news/press-release/2021-251.

[5] *See*: https://www.sec.gov/news/press-release/2021-250.

[6] *See*: https://www.sec.gov/news/press-release/2021-239.

FROM THE EDITOR

An Active SEC Year?

It's no surprise that the first year under a Democratic presidential administration since 2016 was a seemingly non-stop wave of activity and announcements from the Securities and Exchange Commission. With Gary Gensler confirmed as chair in April 2021, the Commission embarked on a bevy of new proposed regulations.

Yet Cornerstone Research and New York University's Pollack Center for Law & Business, in a recent survey of SEC enforcement activity, found that fiscal year 2021 was also the second year in a row in which the number of SEC actions against public company and subsidiary defendants declined. Stephen Choi, Director of the Pollack Center, said in the executive summary that "for the first time in 10 years, there were no public company or subsidiary defendants with admissions of guilt in fiscal year 2021."

Obviously there isn't *that* much of a paradox: the survey's results reflect the last year of Jay Clayton's SEC as much as they do Gensler's first. Also SEC activity tends to drop in a year in which there's a change of SEC leadership, and there were lingering slowdown effects from the early COVID-19 pandemic on Commission activity. Also, while the 53 public company/subsidiary actions in FY 2021 were a 15% drop from FY 2020, and the lowest total in seven years, SEC monetary settlements in these actions totaled $1.8 billion. As the survey noted, this is in line with the FY 2012-2020 average of $1.6 billion.

The survey's findings are derived from the Securities Enforcement Empirical Database ("SEED"), a collaboration between the Pollack Center and Cornerstone. (As of Sept. 30, 2021, SEED identified 751 SEC actions initiated against public companies since October 1, 2009.) Other settlement figures of note: in FY 2021, the SEC filed five actions related to COVID-19 and one action against a special purpose acquisition company (see Gensler's speech on SPACs elsewhere this issue)—the latter was the first such action noted in SEED. The median monetary settlement in FY 2021 was $1 million, lower than the average median of $4 million in the FY 2012-2020 range; of the $1.8 billion in monetary settlements imposed on public companies/subsidiaries in FY 2021, nearly half (46%) came from disgorgement and prejudgment interest; roughly 58% of defendants settled, consistent with the FY 2012-2020 average.

In terms of allegations, issuer reporting and disclosure allegations were the primary type, representing over half (51%) of public company/subsidiary actions. Meanwhile Foreign Corrupt Practices Act actions accounted for only 8% of actions against public companies/subsidiaries, the lowest percentage in the SEED period to date. For more on the survey, see here: https://www.cornerstone.com/Publications/Reports/SEC-Enforcement-Activity-Public-Companies-and-Subsidiaries-Fiscal-Year-2021-Update.

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