LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

One Year In, SEC's Gensler Has Delivered A Rulemaking Storm

By **Al Barbarino**

Law360 (April 15, 2022, 10:09 PM EDT) -- After taking the helm of the U.S. Securities and Exchange Commission one year ago, Chair Gary Gensler has set forth an ambitious rulemaking agenda that has accelerated briskly in recent months, imposing lofty disclosure requirements as the agency looks to tighten its grip on a range of players across the financial markets.

The proposals are diverse, applying to both the public and private markets, and touching on everything from climate risks to private funds and cybersecurity. If and when finalized, they would require a large swath of market players to funnel significant resources into collecting and reporting additional data.

"Gensler's administration has moved at a historic pace on the rulemaking front," said Scott Mascianica, a Holland & Knight LLP partner and former SEC assistant director for enforcement who left the agency in December.

"I think you'd be hard-pressed to find any four-month period [from December to the present] where the commission has been this active on the rulemaking front across such a broad swath of the market," said Mascianica. "The rules aren't just significant in their scope, they're seismic in their impact."

Public companies, fund advisers and managers are all currently attempting to make heads or tails of the plethora of proposed rules, grappling with the added compliance responsibilities, costs and burdens they are likely to bring as Gensler pushes his agenda to protect the so-called retail investor.

"While Gensler is a believer in the capital markets as a means of capital formation, he is all about protecting investors ... love him or hate him, that's who he is," said Tom Redburn, chair of Lowenstein Sandler LLP's securities litigation practice.

"There is no question that this administration is laying down a marker that it believes two things: there is insufficient regulation of capital markets, and the regulations that exist in many cases are out of date and need to be substantially updated to reflect current market realities," Redburn said.

Below, some of the securities industry's top attorneys share their views on key rulemakings initiated under Gensler in recent months, what they see as the pros and cons of the proposals, the challenges the rules could bring if they ultimately get the green light, and some tips on how companies, advisers and other entities can approach them.

A Call For Cybersecurity

On Feb. 9, the SEC proposed rules that would require investment advisers and funds to report significant cybersecurity breaches directly to the SEC within just 48 hours if they "reasonably believe" an incident has occurred.

The proposed rule would also require that these entities bolster their cybersecurity preparedness with written cybersecurity policies and publicly disclose cyber incidents that occurred within their last two fiscal years on brochures and registration statements.

A month later, on March 9, the agency followed that up with a proposal that would require public companies to disclose cybersecurity breaches more quickly and explain to the agency what they are doing to address and prevent risks.

"Companies and investors alike would benefit if this information were required in a consistent, comparable and decision-useful manner," Gensler said at the time, repeating a theme that's been ingrained in many of the proposals issued under his watch.

Under the latter proposal, companies would have to report "material" cybersecurity incidents within four business days after spotting them.

Companies would also need to provide periodic updates on the incidents, and describe their cybersecurity risk management policies and the cyber expertise of their board members, among other requirements.

Mascianica of Holland & Knight noted that the proposed rules would "expand the scope of review and purview as to what these entities need to disclose, and impose strict, ongoing reporting obligations."

"That one-two punch will be a significant imposition on both public companies and advisers," he said.

In addition, the proposed rules would require companies and advisers to consider, assess and disclose risks and incidents related to their third-party vendors, adding another layer of complexity and challenge, he said.

"It's unclear that these entities are going to have access to all the information they'll need to engage in a thorough analysis — much less a forensic investigation when an incident occurs — to provide complete disclosures," Mascianica said.

As seen across other proposals under Gensler, such as those focused on climate risk-related disclosures, the cyber rules are bound to impact not just the primary entities subject to the rules, but also their third-party relationships and others who lie further down the supply chain.

"This could result in ripple effects across the IT vendor industry when it comes to contractual terms and due diligence reviews," Mascianica said about the cyber proposals.

Targeting Private Funds

The commission is attempting to level the playing field between the disclosures of private funds and registered investment products, but there are questions about whether Gensler's efforts in this department go too far.

On **Jan. 26** the agency proposed that private funds increase the information they submit on so-called Form PF, a quarterly disclosure created in 2011 following the financial crisis that provided regulators with data regarding the funds' operations and strategies.

That was followed by a Feb. 9 proposal that would require private fund advisers to provide investors with quarterly disclosures detailing certain information about fund fees, expenses and performance.

While the SEC is laser-focused on protecting retail investors trading publicly registered securities, Gensler at the time cited the explosion of the private investments — a market the SEC estimates at $18 trillion — and the fact that everyday investors' livelihoods rely on the sector as justification for more regulatory intervention.

Kelley Howes, vice chair of Morrison & Foerster LLP's investment management group, said the proposals appear to be an attempt from the commission to align the disclosures of private funds with those of registered products such as mutual funds.

But she argued that bogging private funds down in the minutia of detailed paperwork with tight time frames — in some cases just one business day — isn't the right approach.

"I don't understand why this is necessary," Howes said. "Whether you're managing a large retail business or a private fund business, you've got to be looking at the forest, you've got to be sort of looking at the broad picture."

"When you lose the broad picture because you're so focused on the tiny little bits, I think that could be kind of dangerous," she said.

In addition, investors in private funds already enjoy significant transparency because they typically have a closer relationship with fund managers than investors in mutual funds do, and the efforts could divert the staff of both the SEC and private funds away from more important things, Howes said.

"SEC staff is going to have to look at the data … and that will divert attention away from other things, because they have a limited bandwidth," she said. "So I don't know that that's necessarily a good thing for the retail market."

Gensler noted upon the release of the February proposal that college endowments and pensions are deeply invested in private funds, and that "the people behind those pension funds and endowments often are teachers, firefighters, municipal workers, students and professors."

But Howes didn't fully buy the idea that the rules protect everyday investors, noting that many institutional pensions — like the California Public Employees' Retirement System, for instance — are large and powerful enough to assert plenty of control over private funds on their behalf.

"Underneath those pension funds are the retail people, the 'little people,' right? Absolutely true," she said. "However, you will never convince me that CalPERS has no market strength. You will never be able to suggest to me that they can't negotiate on behalf of their participants."

But while the extra paperwork would bring a substantial burden to fund advisers, if the rules are finalized in similar form to the proposals, the compliance industry could emerge as one clear winner as

private funds scramble for assistance.

"They're going to need help with this," Howes said. "Compliance firms need to be ready for this because this is going to be a significant shift for a lot of private fund advisers."

Insider Traders Get A Surprise

A Dec. 15 agency proposal seeks to address decades-old insider trading concerns about corporations and company insiders, along with another that would bolster disclosures around company stock buybacks.

The insider trading proposal — approved unanimously by the agency's five commissioners — addresses bipartisan concerns about a two-decade-old "affirmative defense" that gave a safe harbor to companies and insiders to trade stock as long as they adopted trading plans in good faith and before becoming aware of material nonpublic information.

"Over the past two decades, we've seen experiences, and we've heard concerns about some gaps in this 21-year-old rule — gaps that today's proposal would help fill," Gensler said during the webcast vote on the proposal.

As part of the proposal, corporate officers or directors who enter into so-called Rule 10b5-1 trading arrangements would be held to a 120-day mandatory cooling-off period before any trading could commence following the adoption of that arrangement, which has raised some eyebrows among company insiders.

While potential changes to the current rules were anticipated after years of talk from the agency, the lengthy cooling-off period took companies by surprise, said Jennifer Porter, a Troutman Pepper partner who advises pharmaceutical, biotech and medical companies on a range of SEC disclosure and governance matters.

"This is significantly longer than what anyone expected, and that's been the reaction we've seen from our clients," she said.

Porter said the companies she works with typically have a 30-day cooling-off period in place, while some employ 14 days.

Anything over 60 days is rare, she added, noting that company officials are generally "not pleased" with the 120-day threshold the SEC has put forward, which they view as unnecessarily long and could dip into their personal lives.

"Sometimes a director or an officer is looking to achieve some liquidity, because they have some sort of life event happening — maybe they want to buy a house or something of that nature, and they want to get some liquidity out of their stock ownership," she said.

Under the proposed rule, issuers would also have to report annually if they have adopted insider trading policies and procedures, or why not.

Deflating the SPAC Market

In late March, the commission proposed tighter rules governing special purpose acquisition companies, or SPACs, which would increase disclosures regarding conflicts of interest, insider compensation, and certain costs and equity dilution involving SPAC deals.

The rules would "strengthen disclosure, marketing standards, and gatekeeper and issuer obligations by market participants in SPACs, helping ensure that investors in these vehicles get protections similar to those when investing in traditional initial public offerings," Gensler said at the time.

The proposal puts forth a complex web of new requirements that would bolster disclosures, lead to more accountability across the various entities involved in SPAC deals and require additional registration documents, explained Redburn of Lowenstein Sandler.

Redburn agrees that the proposed rules would level the playing field between SPACs and traditional IPOs. But he also anticipates that, if passed in its current form or something similar, significant litigation — both between SPAC parties, and against the SEC — will stem from the "heavy-handed" rule.

SPACs, shell companies that raise money through IPOs with the intent of acquiring a private business and then taking it public, exploded in popularity in 2020, aided by pandemic-related stimulus and low interest rates.

They have cooled off in part due to poor post-merger stock performance of some companies, but the proposed rule would likely sink the ship further, Redburn said.

"It undermines some of the principal benefits that make SPACs attractive," he said. "One of the things that made them attractive was that they're not like traditional IPOs, and you didn't have the same robust disclosure requirements and the associated expenses involved with that."

Asked whether the proposed rule would be a good or a bad thing for the market, Redburn said it depends on whom you ask.

"On one hand, [SPACs] enabled a lot more companies to go public than otherwise would have, so if you believe that the public capital markets are the best means of efficiently allocating capital in the United States, that should be a good thing," he said.

On the other side of the debate, some would argue that many of these companies "shouldn't be public companies to begin with," he said.

"Maybe they aren't mature enough yet, or they haven't had enough of a track record, or they're still working out corporate governance kinks, or their product isn't necessarily great," Redburn said. "In that case, the investors on the public capital markets are going to bear the cost of that."

Climate Plan Tackles The 'E' In ESG

On March 21, the agency issued a long-awaited proposal that would impose new climate-related disclosure requirements on public companies, requiring them to disclose greenhouse gas emissions and the business risks related to severe weather events and the transition to a smaller carbon footprint.

"Investors need reliable information about climate risk to make informed investing decisions," Gensler said at the time. "Today's proposal would help issuers more efficiently and effectively disclose these

risks and meet investor demand."

The rules would require reporting of so-called Scope 1 and Scope 2 emissions, which are tied to companies' direct and indirect emissions linked to operations and energy purchases, and in some cases Scope 3 emissions of larger filers, if they are deemed "material" to investors.

"Although the proposal contemplates phase-in periods based on SEC filer status, companies may not be in a position to wait for the final rules before they consider how to begin collecting the greenhouse gas emissions data and other information that may be required," said Raquel Fox, a Skadden Arps Slate Meagher & Flom LLP partner and former senior adviser to onetime SEC Chair Jay Clayton.

Fox says companies should begin putting internal and external teams in place to assess the climate-related data they might currently gather and how it compares to the proposed requirements, while "determining the resources and internal controls necessary for compliance."

Scope 3 disclosures are intended to provide a fuller picture of a company's environmental impacts by factoring in the emissions of their suppliers and customers who use the products, but that also makes them among the most difficult to measure.

Private companies that are part of public companies' supply chains are likely to be impacted and incur significant costs as public companies collect greenhouse gas emissions data from within their supply chains, Fox noted.

"Public companies will expect their suppliers to absorb such data collection efforts as a cost of doing business," she said.

–Additional reporting by Tom Zanki. Editing by Emily Kokoll.

All Content © 2003-2022, Portfolio Media, Inc.