



Securities Quarterly Update

October 2021 | Fall Edition

Welcome to the fall edition of Securities Quarterly Update, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at recent environmental, social, and governance (ESG)-related announcements, SEC enforcement actions, 10b5-1 plans, and Form 10-K and proxy statement considerations, among other topics.

Climate Change Heats Up

The SEC continues to focus on environmental and climate change disclosures. On [July 28](#), SEC Chair Gary Gensler indicated that SEC staff was working on a proposal regarding mandatory climate risk disclosures, which should be “consistent and comparable” and “decision-useful.” The proposal may include qualitative and quantitative disclosure requirements, such as industry-specific metrics or metrics related to greenhouse gas emissions, financial impacts of climate change, or progress toward climate-related goals.

In addition, companies have begun to receive comment letters relating solely to climate-related disclosures, and on [September 22](#), the Division of Corporation Finance released a letter containing sample comments relating to climate-related disclosures, or the lack thereof, many of which appeared in the issued comment letters. For the most part, the comments, both in the sample letter and issued letters, include materiality qualifiers and are consistent with the SEC’s [2010 Guidance Regarding Disclosure Related to Climate Change](#), which outlines the SEC’s views with respect to existing disclosure requirements as they apply to climate change matters.

The sample letter includes comments on risk factor disclosures and, overwhelmingly, disclosures in Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A), including, among other topics:

- climate-related capital expenditures;

- the impact of climate change legislation and regulation and any material increased compliance costs related to climate change;
- the indirect consequences of climate-related regulation or business trends, such as changes in demand for products and services, increased competition to develop lower emission products, increased demand for alternative energy, and reputational risks resulting from operations or products that produce material greenhouse gas emissions; and
- the physical effects of climate change on operations and results.

The sample letter also includes a comment noting discrepancies in the level of disclosure in a company’s sustainability report compared to its SEC filings. Companies should review their sustainability reports, website and other ESG disclosures to ensure that such disclosures are consistent throughout all documents and should determine whether any of them require disclosure in SEC filings (or develop analysis supporting the company’s determination not to include).

While not addressed in the sample letter, companies should also consider whether their financial statements adequately address the impact of environmental and climate change matters. The FASB released an educational paper in [March 2021](#) regarding the intersection of ESG matters with financial accounting standards; FASB staff also issued an invitation to comment in [June 2021](#) that requested input on the effects of ESG matters on financial statement line items, among other topics.

The SEC is currently expected to issue its climate change proposals by the end of 2021 or in early 2022, based on recent remarks by SEC Chair Gensler. Even without a formal proposal, companies should evaluate their climate change disclosures (including disclosures in the next Form 10-Q/K) in light of the 2010 guidance and sample comment letter.

Rule 10b5-1 Trading Plans

Another recent hot topic is Rule 10b5-1, a safe harbor established to allow company insiders to trade shares during trading blackouts pursuant to a written plan adopted while not in possession of material non-public information, in light of concerns regarding potential abuse of such plans. In June 2021, the U.S. Senate reintroduced [legislation](#) that would require the SEC to conduct a study to determine whether Rule 10b5-1 should be amended, report on such study to the U.S. Congress, and then amend the rule consistent with the study's findings; a [similar bill](#) was passed in the U.S. House of Representatives in April 2021. Rule 10b5-1 is also on the SEC's [agenda](#), with proposed rules potentially coming later this year.

On September 9, the SEC's Investor Advisory Committee (IAC) approved [draft subcommittee recommendations](#) related to changes in the operation of Rule 10b5-1 securities trading plans, which included the following:

- a cooling-off period of at least four months between the adoption or modification of a Rule 10b5-1 plan and the first trade under the plan;
- a prohibition on overlapping plans (i.e., having more than one Rule 10b5-1 trading plan in place);
- mandatory disclosure regarding Rule 10b5-1 plans in proxy statements and Form 4 and Form 8-K filings (including information such as the number of shares covered by such plans and adoption, modification, or cancellation of such plans); and
- electronic submission of Form 144.

While the recommendations cover many areas of potential reform suggested by SEC Chair Gensler at the [June 10](#) IAC meeting, they do not address potential limitations on how and when trading plans may be terminated or the intersection of insider trading plans with public company share buyback programs. It remains to be seen whether any

recommendations for proposed rule changes will be made in those areas.

Recent SEC Enforcement Actions

Special Purpose Acquisition Companies (SPACs)

SPACs have been increasingly under scrutiny, both from the SEC and investors. On [July 13](#), the SEC announced an enforcement action against a SPAC, its sponsor, and its CEO, and the merger target and its former CEO, relating to alleged misstatements and failure to disclose certain information in a registration statement and other public statements. All parties settled other than the target's former CEO, who is litigating the claims. The SEC claimed that the SPAC, its sponsor, and its CEO conducted inadequate due diligence, which failed to reveal misstatements and omissions by the target and its former CEO. SPACs and their sponsors should ensure they document and complete due diligence procedures prior to completing a de-SPAC transaction. SPACs are expected to remain an enforcement priority going forward and are also included in the SEC's rulemaking agenda. (For a preview of the types of rule proposals the SEC may issue, see the IAC's recent [recommendations](#) relating to enhanced SPAC disclosures and stricter enforcement of existing rules.) In addition, the SEC previously tightened its SPAC accounting guidance (as further discussed in our [April 2021 Securities Quarterly Update](#)), and it may issue further guidance in this area.

Investors have also filed a number of lawsuits against SPACs. In recent stockholder derivative lawsuits, the plaintiff alleged that a SPAC is an unregistered investment company, with sponsor and director warrants constituting unlawful compensation under the Investment Company Act. In response, over 60 law firms signed a [letter](#) stating that they "view[ed] the assertion that SPACs are investment companies as without factual or legal basis." It remains to be seen what impact, if any, these challenges will have on the SPAC market.

Cybersecurity Disclosures

The SEC continues its intense scrutiny of public statements related to cybersecurity incidents. On [August 16](#), the SEC announced a settled enforcement action against a public company relating to allegedly misleading cybersecurity disclosures. According to the SEC, in March 2019, the

company determined that a large amount of data had been stolen from its servers in 2018, including names, birthdates, and email addresses, due to a security vulnerability of which the company was aware, but for which it did not install a patch until after learning of the incident. Despite being aware of the incident, in a July 2019 SEC filing, the company characterized data privacy incidents as a hypothetical risk and did not disclose the occurrence of such an incident. It also released a statement that included alleged misstatements regarding the incident. The SEC additionally asserted that the company failed to maintain disclosure controls and procedures sufficient to properly assess cybersecurity incidents for potential disclosure.

Companies should regularly review their cybersecurity disclosures to ensure they are not disclosing such incidents as hypothetical if they have actually occurred and their disclosure processes to ensure that any cybersecurity incidents are properly reported internally and evaluated for materiality and disclosure. SEC Chair Gensler has [indicated](#) that SEC staff are working on a proposal regarding cybersecurity risk governance, which may include “cyber hygiene and incident reporting” and is currently expected to be released later this year or in early 2022.

Earnings Per Share (EPS) Initiative

In recent years, the SEC has increased its use of data analytics in its enforcement efforts, including as part of its EPS Initiative, which is designed to detect “potential accounting and disclosure violations caused by, among other things, earnings management practices.” On [August 24](#), the SEC announced settlement of an enforcement action against a company and its former CFO for alleged accounting and disclosure violations that allegedly resulted in the company reporting inflated earnings per share, which enabled the company to meet research analysts’ consensus estimates for multiple quarters. According to the release, this was the third action resulting from the EPS Initiative.

Auditor Independence

On [August 2](#), the SEC announced a settled enforcement action against Ernst & Young, one of its partners, and two of its former partners, who were charged with improper professional conduct for violating auditor independence rules. The SEC found that, during a request for proposal process, the partners worked with the target client’s then-

chief accounting officer to obtain confidential competitive information and audit committee information. The former CAO was also separately charged for his role in the alleged misconduct, including for alleged disclosure violations by the company resulting from his actions.

2022 Proxy Season Considerations

Nasdaq Diversity Rules

On [August 6](#), the SEC approved Nasdaq’s proposed [diversity rules](#), pursuant to which Nasdaq-listed companies are now required to disclose board diversity statistics and, for most companies, to have, or explain why they do not have, at least two diverse directors on their board of directors, including one who self-identifies as female and another who self-identifies as either an underrepresented minority or LGBTQ+. (There are certain exceptions for smaller reporting companies, foreign companies, and companies with five or fewer board members.)

- *Diversity matrix:* Nasdaq-listed companies are required to disclose their diversity statistics pursuant to a [board diversity matrix](#) at least once a year. The matrix, which is required to be searchable, can be included in a proxy statement or on a company’s website, in which case the company will need to submit the matrix concurrently with the proxy statement and submit a URL link through the Nasdaq Listing Center within one business day after posting. Companies are required to provide the matrix by the later of August 8, 2022 or the date they file their proxy statement for the annual stockholders’ meeting during 2022.
- *Board diversity:* The new rules also require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and another who self-identifies as either an underrepresented minority or LGBTQ+. Smaller reporting companies may comply with this requirement by having at least one female director; the second diverse director may self-identify as female, LGBTQ+, or an underrepresented minority. Companies will be required to disclose explanations regarding non-compliance with this requirement in a proxy statement or on their website, in which case they will need to submit the disclosure concurrently with their proxy statement and submit a URL link through the Nasdaq Listing Center within one business day after posting. Nasdaq has created a two-stage transition process for this requirement.

- *One diverse director:* All Nasdaq-listed companies will be required to have at least one diverse director, or explain why they do not, by the later of August 7, 2023 or the date they file their proxy statement for the annual stockholders' meeting during 2023.
- *Two diverse directors:* Companies listed on the Nasdaq Global or Global Select markets will be required to have two diverse directors, or explain why they do not, by the later of August 6, 2025 or the date they file their proxy statement for the annual stockholders' meeting during 2025; companies listed on the Nasdaq Capital Market will have until the later of August 6, 2026 or the date they file their proxy statement for the annual stockholders' meeting during 2026. (Companies with five or fewer directors are not required to comply with this requirement.)

Newly listed Nasdaq companies will have certain phase-in periods for compliance with these rules, so long as they were not previously subject to substantially similar requirements of another national securities exchange.

For additional information, Nasdaq has posted [FAQs](#), as well as a [summary article](#).

Although lawsuits have already been filed challenging these rules, Nasdaq-listed companies should plan to comply with these requirements.

NYSE "Votes Cast" Calculation

One area that causes a fair amount of confusion is calculation of stockholder votes; for some NYSE-listed companies, the calculation is further complicated by NYSE's voting standards. NYSE rules currently require a minimum vote of a majority of "votes cast" on matters that require stockholder approval under NYSE's rules. Under many states' laws, abstentions are not counted under a "votes cast" voting standard; however, under current NYSE rules, abstentions *are* considered votes cast, requiring many companies with a "votes cast" standard to calculate the votes on such matters in a different manner than is required under applicable state law.

On [September 29](#), the NYSE proposed a rule amendment intended to remove this gap. The proposed rule would require companies to calculate "votes cast" on applicable proposals in accordance with their own governing

documents and any applicable state law. This approach is similar to Nasdaq's treatment of "votes cast," as described in an [FAQ](#).

Increased Stockholder Engagement

In [October 2021](#), BlackRock announced that it will provide institutional index investors (representing approximately 40% of BlackRock's managed assets) with the option to vote their own holdings instead of casting votes on their behalf. For some companies, this may necessitate additional stockholder engagement.

D&O Questionnaires

While Nasdaq-listed issuers will need to include questions soliciting information required to complete the new diversity matrix described above, all companies should consider including questions soliciting diversity information in their D&O questionnaires to the extent they do not already do so, including information required by any applicable state law diversity requirements.

NYSE-listed issuers should ensure their questions relating to related party transactions reflect the updated rules, as described below; companies whose questions reflect the requirements in Item 404 of Regulation S-K likely will not need to make any changes.

Companies that use their D&O questionnaires to collect information for compliance with Section 13(r) of the Securities and Exchange Act of 1934 should review the recent additions to Executive Order 13882 to ensure their questions cover all relevant parties. (See the [July 2021 Securities Quarterly Update](#) for additional information.)

Corporate Governance Considerations

NYSE Related Party Transaction Requirements

In April 2021, the SEC [approved](#) an NYSE proposal amending its requirements for approval of related party transactions; among other things, the new provisions aligned the definition of related party transactions with the SEC's definition in Item 404 of Regulation S-K, "but without applying the transaction value threshold under that provision." This language resulted in the elimination of any materiality or transaction value thresholds for related party transaction review, potentially resulting in all such

transactions, regardless of materiality, being subject to independent director review.

On [August 26](#), the SEC approved an NYSE proposal to further amend its related party transaction review requirements to remove the language described above; accordingly, the related party transaction approval requirements now apply only to transactions required to be disclosed pursuant to the materiality and transaction value thresholds in Item 404 (which, for most companies (other than smaller reporting companies), is a transaction value of \$120,000).

Compensation Clawbacks

On [October 6](#), the SEC announced a meeting scheduled for October 13 to consider whether to reopen the comment period for the [clawback proposal issued in 2015](#), which would direct stock exchanges to require listed companies to implement clawback policies (that is, policies to recover incentive-based compensation) in the event of an accounting restatement (without the misconduct requirement).

Form 10-K Reminders

Companies with September 30 fiscal year-ends will be required to comply with the amended MD&A rules (described further in the [January 2021 Securities Quarterly Update](#)) in their upcoming Forms 10-K. (Companies will also be required to comply with these rules in their registration statements and prospectuses that, on their initial filing date, are required to contain financial statements for a period on or after August 9, 2021.)

As noted below, Form 10-K includes a new Item 9C, which became effective in May 2021. Companies to which the disclosure does not apply should include the heading and “not applicable” or similar disclosure.

When completing the annual review of risk factors, companies should particularly focus on their cybersecurity disclosures and whether any climate and other ESG-related disclosures should be included or expanded.

China-Based Company IPOs

The SEC has recently paused listings of China-based companies on U.S. securities exchanges and begun requesting additional disclosures from such companies, in

accordance with recent announcements by SEC Chair Gensler on [July 30](#) and [August 16](#). Among other things, the SEC will require disclosure regarding a shell company’s management services from the operating company and risks related to future actions by the government of the People’s Republic of China. These actions follow the recent adoption of [new SEC disclosure requirements](#) implemented pursuant to the Holding Foreign Companies Accountable Act, including the addition of Item 9C to Form 10-K, as further described in the [July 2021 Securities Quarterly Update](#).

Technical Changes

- Effective October 1, SEC registration filing fees [decreased](#) to \$92.70 per \$1.0 million (i.e., fees will be calculated by multiplying the aggregate offering amount by .0000927).
- In its ongoing efforts to make EDGAR more user-friendly, on [August 19](#), the SEC announced the release of Application Programming Interfaces (APIs) that aggregate financial statement data, which are intended to make corporate disclosures faster and easier for developers and third-party services to use.
- On [September 30](#), the SEC announced [EDGAR Next—Improving Filer Access and Account Management](#), an initiative relating to potential technical changes to EDGAR filer system access to make submissions and account management processes, and posted a [request for comment](#). Comments are due by December 1.

FOR MORE INFORMATION

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2021 Editions of *Securities Quarterly Update*

- [Q1 | January 2021](#)
- [Q2 | April 2021](#)
- [Q3 | July 2021](#)

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