



Securities Quarterly Update

July 2020

Recent Developments Applicable to Second Quarter Quarterly Reports

Welcome to the summer issue of Securities Quarterly Update, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at ongoing disclosure developments related to COVID-19 in the first half of 2020 that public companies should consider as they prepare their Form 10-Q filings for the second quarter of 2020, as well as other general updates in securities laws and regulations.

Filing Deadlines and Changes to “Accelerated” and “Large Accelerated” Filer Definitions

In March, subject to conditions, the SEC staff provided to public companies impacted by COVID-19 a 45-day extension to make certain SEC filings (including reports on Form 10-Q and Form 10-K) that would otherwise have been due on or before July 1. As announced in June, the SEC staff believes that “further extension of this relief is unnecessary.”

As such, all quarterly reports on Form 10-Q for the second quarter of 2020 (assuming the December 31 fiscal year end) revert to the normal filing schedule (40 days after fiscal quarter end for large accelerated filers and accelerated filers and 45 days after fiscal quarter end for non-accelerated filers).

As companies are calculating their non-affiliate public float as of the end of the second fiscal quarter, recall that the SEC has recently adopted amendments to the “accelerated filer” and “large accelerated filer” definitions, which, among other things, exclude from these definitions “smaller reporting companies” that had annual revenues of less than \$100 million in the last fiscal year. The amendments became effective on April 27 and apply to the annual reports due on or after that date.

The company’s status as a “non-accelerated filer,” an “accelerated filer” or a “large accelerated filer” (determined at the end of the fiscal year using the second quarter end non-affiliate public float calculations) determines the company’s filing deadlines for periodic reports, with, as noted above, non-accelerated filers enjoying longer time frames. A filer with a December 31 fiscal year end will retain its current status until the end of 2020 and will reflect any change in its filer status on its annual report to be filed in 2021. The amendments further increase the thresholds for exiting “accelerated” and “large accelerated” filer status and create more complexity by adding a revenue test to the exit thresholds.

Most significantly, as a result of the amendments, some smaller public companies will no longer be required to incur the expense of the SOX 404(b) auditor assessment of the effectiveness of internal control over financial reporting. Management’s report on the effectiveness of internal control over financial reporting will still be required. Annual reports on Form 10-K will include an additional check box indicating whether an auditor assessment of the effectiveness of internal control is required.

Note that companies with non-affiliate public floats between \$75 million and \$250 million remain subject to all

of the accelerated filer requirements unless their annual revenues are less than \$100 million.

Inline XBRL Reminder

Accelerated filers should ensure that Inline XBRL (iXBRL) tags are included in their Forms 10-Q. Accelerated filers are required to begin using iXBRL in reports for fiscal periods ending on or after June 15, 2020, and non-accelerated filers are required comply with iXBRL requirements for fiscal periods ending on or after June 15, 2021. The requirements are triggered for the first Form 10-Q for the fiscal quarter ending on or after the applicable compliance date.

Remember to tag cover pages of subsequently filed current reports on Form 8-K and to include Exhibit 104 referencing iXBRL tags on the cover page, which is required if any other exhibits are being filed with the Form 8-K.

Corporation Finance Update: Topic No. 9A Discusses Additional COVID-19 Disclosure Considerations That Could Impact MD&A

On June 23, the SEC's Division of Corporation Finance published [CF Disclosure Guidance: Topic No. 9A](#), supplementing CF Disclosure Guidance Topic No. 9 issued on March 25 ("June Guidance"), in which the SEC staff provided companies with additional guidance on disclosure considerations related to the impact of COVID-19 on their businesses, financial condition and results of operations. The SEC staff continued to encourage companies to discuss management's assessment of COVID-19's impact so that investors can evaluate the current and expected effects on the company's operations, both within earnings releases and, to the extent material to the business, in the MD&A section of the company's periodic reports. Companies have had to make a broad range of operational and financial adjustments in response to COVID-19 (such as suspension of operations, supply chain adjustments, and actions relating to short- and long-term funding). Where COVID-19-related adjustments may affect a company in a way that would be material to an investment or voting decision, the company should carefully consider disclosure of this information to investors. As always, any forward-looking information carries risks and should be carefully assessed and cautioned when included in SEC filings.

In the June Guidance, the SEC staff provides a list of questions for companies to consider as they assess materiality of specific facts and circumstances on company operations, broadly covering the following topics:

- Material operational challenges facing management and the board of directors
- Overall liquidity position and outlook, including impact of COVID-19 on revenues and cash flow from operations
- Access to revolving lines of credit or recent capital-raising transactions in public or private markets
- Impact of COVID-19 on access to traditional funding sources
- Material risk of default on covenants in credit and other agreements and the ability to timely service debt and other obligations
- Reduction in capital expenditures, halt in material business operations or disposal of material assets or lines of business
- Changes in terms with customers, such as expanded payment terms or refund periods, or modification of other contractual arrangements
- Reliance on supply chain financing, structured trade payables, reverse factoring or vendor financing to manage cash flow
- Impact of material events after the end of the reporting period but before financial statements are issued

In each of these areas, the SEC staff asks companies to consider whether any of these new developments have or may have a material impact on a company's balance sheet, statement of cash flows or short- and long-term liquidity, and if so, how? The SEC staff also emphasizes that management should consider discussing whether any future liquidity challenges are anticipated once any debt concessions or other payment deferrals or accommodations have lapsed.

The SEC staff notes that companies that have received COVID-19 government assistance under the CARES Act should consider discussing how the government loan has impacted the company's financial condition, liquidity and capital resources, the material terms and conditions of the

assistance received and management's estimates on being able to comply with such terms and conditions, whether the company is taking advantage of tax relief available under the CARES Act and how it impacts short- and long-term liquidity, and whether the government assistance involves material accounting estimates or judgments (such as the probability that a loan will be forgiven) that should be disclosed. If COVID-19 has impacted management's assessment about the company's ability to continue as a going concern (that is, COVID-19 effects have raised substantial doubt about the company's ability to meet obligations as they become due within one year after financial statements are issued), additional disclosures should be made within the MD&A about the conditions and events that led to this conclusion and any plans management has to address these challenges.

SEC Staff Update: Temporary Relief for Manual Signatures

On June 25, the SEC staff, including the Divisions of Corporation Finance, Investment Management and Trading Markets, issued [an updated statement](#) regarding Rule 302(b) of Regulation S-T, which requires that each signatory to documents that are filed electronically with the SEC manually sign each signature page "authenticating, acknowledging or otherwise adopting" their signature appearing on the electronic filing, either before or at the time of such filing; and that such manual signatures be retained by the company for five years after such filing is made.

On March 24, the SEC staff first issued a statement providing relief from the manual signature requirement due to COVID-19 concerns, stating that although the staff still expects companies to comply "to the fullest extent practicable," it acknowledged that in light of the current circumstances, companies may be facing difficulties complying with the manual signature requirement. As a result, the staff would not recommend enforcement action under Section 302(b) as long as the signatory retains a manually signed signature page and provides such document as promptly as reasonably practicable to the filer for retain in the ordinary course, such document indicates the date and time when it was signed, and the filer

establishes policies and procedures governing the temporarily modified retention process.

On June 25, the SEC staff issued an updated announcement extending such relief for manual signatures and reminding filers that the relief granted is temporary and will remain in effect until the staff provides public notice of its expiration (which will be published at least two weeks before the termination date of the relief).

Filers should continue to be vigilant about manual signatures in remote work situations. For example, signatories can take a photograph or a make PDF copy at the time of signature and retain the original signature page until they return to the office.

SEC Staff Update: Temporary Relief for Form 144 Paper Filings

Similar to the relief granted for manual signatures, on June 25, the Division of Corporation Finance [issued a statement](#) that, in light of COVID-19 health and safety considerations and the logistical difficulties of submitting paper Forms 144, the SEC staff is extending its relief and will not recommend enforcement action to the Commission if, instead of mailing or delivering to the SEC Forms 144 filed pursuant to Rules 101(b)(4) or 101(c)(6) of Regulation S-T, a filer sends an email to the SEC at PaperForms144@SEC.gov with an electronic copy as a PDF attachment. If manual signatures on the Form 144 are not possible, the staff will allow the filer to provide a typed conformed signature on the filing if the signatory retains a manual signed copy and provides such manual signature as soon as practicable upon request by the SEC staff, such signed copy indicates the date and time of execution, and the filer or submitter maintains policies and procedures governing this alternative electronic filing process.

Forms ID for SEC Filing Codes – Temporary Final Rule 10(c) Expired on July 1

On March 26, the SEC adopted [temporary final rules](#) to provide relief to parties seeking to file a Form ID for gaining access to Electronic Data Gathering, Analysis and Retrieval (EDGAR) by eliminating the need to submit a notarized document in order to authenticate the Form ID

filing, as required by Rule 10 of Regulation S-T. On July 1, the SEC [announced](#) that the temporary relief due to COVID-19 considerations would expire after July 1 and filers would once again need to comply with the requirements of Rule 10, including submitting a manually signed document with the requisite notarization, for purposes of obtaining access codes. As noted in the SEC's announcement, the EDGAR Filer Support will continue to work with filers to accept electronic and remote online notarizations.

ESG Disclosures

To the extent that companies are considering including or incorporating any environmental, social and governance (ESG) disclosures in their SEC filings, in response to the COVID-19 pandemic or otherwise, companies should be mindful of potential liabilities and should carefully integrate such ESG statements into their internal controls and procedures.

M&A Guidance: SEC Provides Final Rule Amendments to Simplify Disclosure Requirements for Pro Forma Financials

In connection with its proposed amendments originally published in May 2019 aimed at improving the financial information required in connection with the acquisition and disposition of businesses, the SEC published [final rule amendments](#) on June 23 ("Final Amendments") amending Rule 3-05 (*Financial statements of businesses acquired or to be acquired*), Rule 3-14 (*Special instructions for real estate operations to be acquired*) and Article 11 (*Pro Forma Financial Information*) of Regulation S-X and making corresponding changes to Article 8 that applies to smaller reporting companies. As noted in the final release (No. 33-10786), the Final Amendments' purpose is to facilitate more timely access to capital and reduce the complexity and costs to prepare the related financial disclosures. The final rules take effect on January 1, 2021; however, companies can choose to comply with the amendments immediately (as long as they comply with all of the amendments).

Rule 3-05 of Regulation S-X requires a company to provide separate pre-acquisition financial statements (audited annual and unaudited interim financials) if the company

acquired a significant business or such acquisition is probable. The "significance" of the acquired business, which determines how many years of financials must be provided, is measured by the asset, investment and income tests. When separate financial statements are required under Rule 3-05, Article 11 of Regulation S-X requires registrants to file unaudited pro forma financial information, including a condensed pro forma balance sheet and a condensed pro forma income statement, based on the historical financials of the company and the acquired business and including adjustments reflecting how the acquisition or disposition might have affected the financial statements disclosed if the transaction had been effected at an earlier time.

Press releases issued by the SEC in connection with the proposed and final amendments describe some of the revisions to the current rules effected by the amendments as follows:

- **Updating the investment and income significance tests.** The Final Amendments modified the tests for determining when an acquisition or disposition is "significant" by revising the investment test to compare the registrant's investments in the acquired business to the registrant's aggregate worldwide market value, if available (versus the total assets of the registrant); adding a revenue component to the income test (comparing the registrant's proportionate share of consolidated total revenues in the acquired business to consolidated revenues of the registrant for the most recent completed fiscal year) (which is particularly helpful in cases where the income test in the past would have generated anomalous outcomes); expanding the use of pro forma financial information in measuring significance; and conforming, to the extent applicable, the significance threshold and tests for disposed business to those used for acquired businesses (which increased the significance percentage for business dispositions from 10% to 20%, in some cases eliminating costly preparation and filing of pro forma financial statements).
- **Reducing the financial statements for the acquired business required to be disclosed from the three most recent years to the two most recent years.** The SEC commented that, "Due to their age, the third year of Rule 3-05 Financial Statements is less likely to be indicative of the current financial condition, changes in

financial condition, and results of operations of the acquired business.”

- **Clarifying when financial statements and pro forma financials are required.** The SEC clarified that financial statements are required under Rule 3-05 if a business acquisition has occurred during the most recent fiscal year or subsequent interim period for which a balance sheet is required by Rule 3-01 of Regulation S-X or if an acquisition has occurred or is probable after the date that the most recent balance sheet has been filed.
- **Amending the pro forma financial information requirements and adjustment criteria.** The revised adjustment criteria provide for “Transaction Accounting Adjustments,” “Autonomous Entity Adjustments” and optional “Management’s Adjustments,” each as further described in the Final Amendments. Note that “Management’s Adjustments” (e.g., synergies of the transaction) are now optional and permitted “if, in management’s opinion, such adjustments would enhance an understanding of the pro forma effects of the transaction.”
- **Eliminating the requirement to provide separate financials for an acquired business once the business has been included in the company’s post-acquisition financials for nine months or one complete year (depending on the significance of the acquisition).** The Final Amendments allow registrants to omit acquisition financial statements for businesses with significance exceeding 20%, but less than 40%, once they are included in the registrant’s audited post-acquisition results for nine months.

Executive Compensation Update: SEC Settles Order Instituting Proceedings for Failing to Properly Disclose Perquisites and Benefits Provided to Former CEO

The SEC’s focus on perquisite disclosures continues. The SEC’s Philadelphia Regional Office recently provided a reminder to companies of the importance of disclosing compensation paid to named executive officers, including perks and benefits, within their proxy statements, as well as the importance of having robust internal controls in place to ensure shareholders are receiving this information on a timely basis. On June 4, the SEC entered a [cease-and-desist order](#) against Argo Group International Holdings, Ltd. (“Argo”), an international underwriter of specialty

insurance and reinsurance products (Administrative Proceeding File No. 3-19822), requiring Argo to pay a \$900,000 civil monetary penalty for failing to properly disclose \$5.3 million in perquisites paid to its former chief executive officer over the five-year period between 2014 and 2018. The SEC’s order states that the definitive proxy statements filed in this time period disclosed an aggregate of \$1.22 million worth of perquisites and personal benefits provided to Mark E. Watson III, the chief executive officer, president and a director of Argo from 2000 until his resignation late 2019, consisting of 401(k) and retirement contributions, insurance coverage, supplemental executive retirement plan benefits, housing and home leave allowances, medical premiums and financial planning services. However, Argo failed to disclose an additional \$5.3 million in perquisites Watson received over the same time period, including expenses associated with personal use of corporate aircraft; rent and other housing costs; personal use of corporate automobiles; helicopter trips; other personal travel costs; use of a car service by family members; club and concierge service memberships; tickets and transportation to sporting, fashion and other entertainment events; personal services provided by Argo employees; and watercraft-related costs.

The SEC stated that “Argo incorrectly recorded payments for the benefit of, and reimbursements to, Watson as business expenses, and not compensation. As a result, its books, records, and accounts did not, in reasonable detail, accurately and fairly reflect its disposition of assets.” In addition, Argo failed to maintain internal accounting controls to ensure that transactions were properly recorded and to provide accurate documentation of and controls related to expense reimbursements.

The SEC cited, among other applicable federal securities law provisions, violations of Section 14(a) of the Exchange Act, which makes it unlawful to solicit any proxy in respect of any security registered under Section 12 of the Exchange Act in contravention of the SEC’s rules and regulations, along with Rules 14a-3 and 14a-9, and Item 402 of Regulation S-K, which requires that companies disclose the total value of all perquisites and other personal benefits provided to named executive officers who receive at least \$10,000 worth of such items in a given year.

The Argo order provides a stark reminder that companies should conduct ongoing assessments of the perquisites provided to named executive officers and internal controls currently in place to ensure accurate reporting of this information to shareholders.

Securities Litigation Update: Supreme Court Rules on *Liu Et Al. v. Securities and Exchange Commission*

As highlighted in the [April 2020 edition of Securities Quarterly](#), many have been patiently awaiting a ruling from the U.S. Supreme Court after oral arguments were held on March 3 in the case *Liu Et. Al. v. Securities and Exchange Commission*, No. 18-1501, in which the Court was faced with the question of whether Section 21 of the Exchange Act, which governs available remedies in the context of a federal SEC enforcement proceeding, properly includes disgorgement of ill-gotten gains within the meaning of “equitable relief that may be appropriate or necessary for the benefit of investors.” (See 15 U. S. C. §78u(d)(5)).

Working against the backdrop of *Kokesh v. SEC*, a 2017 case in which the Supreme Court stated that for purposes of the applicable statute of limitations for proceedings seeking to enforce civil penalties, disgorgement constitutes a penalty, on June 22 the Court in *Liu* ultimately maintained, in an 8-1 opinion, that disgorgement does, in fact, constitute equitable relief in civil proceedings and therefore would not constitute punitive sanctions that are normally excluded from equitable relief. However, the Court added two limiting factors in its opinion by requiring that the disgorgement “does not exceed a wrongdoer’s net profits” and is awarded for the victims of the subject securities fraud claim. The Court reasoned that, although “[e]quity practice has long authorized courts to strip wrongdoers of their ill-gotten gains,” to keep disgorgement within the bounds of “a traditional form of equitable relief,” the relief granted should be limited to the “fair compensation of the person wronged” (in other words, the net profit realized from the defendant’s unlawful activity, after deducting “legitimate” business expenses).

The Court was careful to note that *Kokesh* declined to address the question of whether disgorgement was an

available remedy at equity and therefore could be used by courts within SEC enforcement proceedings. After ruling that the SEC may continue to seek the equitable disgorgement remedy in civil cases, the Court remanded to the District Court for the Ninth Circuit to determine net profits from the defendants’ wrongdoing. Notably, the Supreme Court declined to rule on the defendants’ narrower arguments that disgorgement should be limited to cases only in which fraud victims can be identified and disgorgement liability should not be imposed by the SEC on a wrongdoer’s affiliates through joint and several liability, stating that the lower courts should evaluate these questions in the context of equitable principles.

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