



Securities Quarterly Update

July 2021 | Summer Edition

Welcome to the summer edition of Securities Quarterly Update, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at the SEC's regulatory agenda, ESG-related developments, Rule 10b5-1 insider stock trading plans, company stock repurchase programs, regulatory developments impacting Forms 10-Q/10-K, and recent SEC enforcement activity concerning cyber-related disclosure controls and procedures, risk factor disclosures and whistleblower rules.

SEC Announces Annual Regulatory Agenda

On [June 11](#), the Securities and Exchange Commission (SEC) released its first regulatory agenda ("Reg Flex Agenda") under SEC Chair Gary Gensler. While not binding on the SEC, the Reg Flex Agenda sets forth short- and long-term regulatory actions the SEC plans to accomplish, including the following proposed and final rulemaking areas:

- Disclosure relating to climate risk; human capital, including workforce diversity and corporate board diversity; and cybersecurity risk (with proposed rulemaking currently scheduled for October 2021)
- Stock buybacks, short sale disclosure, securities-based swaps ownership and the stock loan market
- Rule 10b5-1 stock trading plans
- Unfinished rulemaking under the Dodd-Frank Act, including clawbacks and pay for performance, security-based swaps and conflicts of interest in securitizations
- Regulation of proxy advisors (such as ISS and Glass Lewis), universal proxy (for contested shareholder meetings) and Rule 14a-8 shareholder proposals (with plans to amend "proxy plumbing" indefinitely delayed)
- Regulation of special purpose acquisition companies (SPACs)
- Market structure modernization
- Mandated electronic filings, filing fee modernization and regulation of transfer agents

The Reg Flex Agenda, however, set aside (to the long-term agenda with the next action not determined) "Amendments to Rule 701/Form S-8," which had made headway under the leadership of former SEC Chair Jay Clayton.

ESG, Human Capital & Climate Change Disclosures

In addition to environmental, social and governance (ESG) matters now featuring prominently on the Reg Flex Agenda, Chair Gensler provided some additional color in his [remarks](#) on June 23. Chair Gensler indicated that he had asked SEC staff to

- develop "recommendations on mandatory company disclosures on climate risk and on human capital," including "around governance, strategy, and risk management related to climate risk," which suggests narrative disclosure;
- take a look at "a range of specific metrics, such as greenhouse gas emissions";
- consider "potential requirements for companies that have made forward-looking climate commitments, or that have significant operations in jurisdictions with national requirements to achieve specific, climate-related targets"; and
- develop recommendations on additional human capital disclosure that "could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety."

Directors' ESG Expertise

On June 28, SEC Commissioner Allison Herren Lee [discussed](#) boards of directors' ESG-related obligations, calling for enhancement of board diversity and increasing board expertise to effectively address climate and other ESG risks. Commissioner Lee suggested that "[companies'] efforts could include integrating ESG considerations into their nominating processes in order to recruit directors that will bring ESG expertise to the board; training and education efforts to enhance board members' expertise on ESG matters; and considering engagement with outside experts to provide advice and guidance to boards." Commissioner Lee further advocated linking executive compensation with ESG metrics.

Other ESG Developments

Shareholder ESG Activity

The number of ESG-based shareholder proposals at large companies has also reached new heights. At Chevron's 2021 annual meeting, shareholders voted in favor of a shareholder proposal requiring Chevron to reduce its scope 3 (indirect) greenhouse gas emissions. At Exxon Mobil's 2021 annual meeting, a dissident shareholder was able to have some of its director candidates elected to Exxon Mobil's board of directors despite holding a small stake in the company by pushing the company to shift its fossil fuel-focused strategy. The dissident's success at Exxon Mobil demonstrates increasing willingness by mainstream investors to engage on climate-based topics, particularly when ESG issues are linked to the company's financial and operational performance. In addition, in 2021, some investors voted against "say-on-pay" proposals of large companies because their executive compensation programs did not include quantitative ESG metrics. Last, but not least, in the Netherlands, a court ordered Shell to significantly reduce its carbon emissions.

ESG Legislation

In the United States, the Biden administration is focused on ESG issues. The recent passage of the [Corporate Governance Improvement and Investor Protection Act/ESG Disclosure Simplification Act](#) of 2021 by the House of

Representatives, albeit by a narrow margin, and a proliferation of ESG bills at the federal, state and international levels may be foreshadowing the introduction of overarching disclosure standards that tie in standardized ESG metrics. If it were to pass in the Senate (which many view as unlikely), the Corporate Governance Improvement and Investor Protection Act would require the SEC to provide for standardized ESG disclosures. It would also specifically require disclosures related to climate change, political spending, taxation, executive and non-executive pay (with comparisons), workforce composition and supply chains, among other issues.

Europe's ESG legislation is further along than that in the United States, necessitating companies that have investors, do business or are listed in Europe to prepare for and monitor requirements. Even for smaller companies without institutional investors, ESG is finding its way into boardrooms.

Insider Rule 10b5-1 Stock Trading Plans & Company Stock Buybacks

The Reg Flex Agenda indicates that the SEC may propose "amendments to address concerns about the use of the affirmative defense provision of Exchange Act Rule 10b5-1," which allows corporate insiders and companies to establish a trading plan for selling or buying stocks they own at a predetermined time without implicating insider trading concerns. On June 7, in his [prepared remarks](#), Chair Gensler announced that he had asked SEC staff to recommend changes to Rule 10b5-1. At the meeting of the SEC's Investor Advisory Committee on [June 10](#), Chair Gensler again raised concerns of potential abuses of Rule 10b5-1. To fill "real cracks in our insider trading regime," he suggested introducing the following to Rule 10b5-1:

- A cooling-off period (4-6 months) after plan adoption (which is significantly longer than what is currently considered to be "best practices")
- Limitations on when and how plans can be cancelled
- Mandatory disclosure requirements in connection with Rule 10b5-1 plans
- Limits on the number of Rule 10b5-1 plans that insiders may adopt

Additionally, the Reg Flex Agenda contemplates reforms related to the use of Rule 10b5-1 plans by companies to repurchase their shares. Further, proposed rulemaking relating to modernization of stock repurchase disclosures is currently scheduled for April 2022.

In June, the [Promoting Transparent Standards for Corporate Insiders Act](#) was reintroduced in the Senate by a bipartisan effort. It calls for the SEC to study whether Rule 10b5-1 should be amended and then adopt such amendments.

Companies and their executives and directors should take these developments into consideration when adopting new Rule 10b5-1 plans or considering amendments to or termination of such plans.

Schedule 13D Filing Deadlines

In June, Chair Gensler [stated](#) that he had asked SEC staff to consider updating beneficial reporting rules, “including possibly shortening reporting deadlines.” Under the SEC’s existing rules, shareholders who have control intent and hold more than 5% of a public company’s equity securities have 10 days to report their ownership on Schedule 13D. Shorter deadlines would provide more visibility to companies when activists are accumulating company stock.

Chair Gensler’s interest may also signal the SEC’s renewed interest in this area. Accordingly, filers should review their reporting obligations for their initial Schedule 13D and circumstances requiring an amendment.

Proxy Advisors & Shareholder Proposals

The Reg Flex Agenda and the SEC’s recent announcements indicate that the SEC plans to revisit its 2020 amendments to its proxy rules, which codified the SEC’s [Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice](#). The 2020 amendments essentially required proxy advisors to provide conflict disclosures, provide their voting recommendations to companies at the same time as to proxy advisors’ clients, and make company responses available to proxy advisors’ clients. The litigation challenge to the 2020 amendments by ISS remains pending. On June 1, the SEC’s Division of Corporation Finance [announced](#) that it will not enforce its 2019 interpretation and the 2020 amendments to Rules 14a-1, 14a-2(b) and

14a-9 “during the period in which the Commission is considering further regulatory action in this area.”

Rule 14a-8 also appears on the Reg Flex Agenda, which casts doubts on whether the SEC will enforce its previous amendments to the procedural requirements and resubmission thresholds for shareholder proposals under Rule 14a-8. In addition, in June, Interfaith Center on Corporate Responsibility (ICCR), As You Sow and James McRitchie filed a lawsuit to overturn the SEC’s revisions to Rule 14a-8. As such, companies will need to monitor the status of the rules for shareholder meetings in 2022.

Final Rule Stage Items

Notable final rules currently scheduled for October 2021 include amendments to filing fee disclosures and payment methods and Rule 144 holding period and filing requirements. If adopted in their proposed form, Rule 144 amendments may require increased coordination between companies and insiders’ brokers. Final rules with respect to universal proxy and pay for performance amendments are scheduled to be rolled out in April 2022.

The SEC’s rulemaking is subject to a public comment period following the publication of proposed rules, and the rules often include transition periods following their effectiveness. In some cases, the SEC may choose to act swifter through issuance of staff guidance.

Passphrase for EDGAR Filing Codes

On June 22, the SEC [announced](#) that filers who have lost their passphrase are required to upload documentation demonstrating the relationships between the entity requesting access and the existing EDGAR account, and the entity requesting access and the individual acting on behalf of that entity. Filers are advised to provide at least five business days, during which they may receive requests from SEC staff for additional information and documents.

Inline XBRL Reminder

Pursuant to the SEC’s [Phase-In of the Inline XBRL Requirements](#), non-accelerated filers will be required to comply with Inline XBRL requirements for fiscal periods ending on or after **June 15, 2021**. Non-accelerated filers

should update the Form 10-Q exhibit index accordingly and remember to tag cover pages of subsequently filed current reports on Form 8-K (also including Exhibit 104 referencing Inline XBRL tags on the cover page, which is required if any other exhibits are being filed with the Form 8-K).

Section 13(r) Disclosures/Iran Notices

The U.S. Secretary of State's recent designation of various organizations affiliated with the Russian government (including the Russian Federal Security Service (FSB)) as parties subject to Executive Order 13382 for undertaking "activities or transactions that have materially contributed to, or pose a risk of materially contributing to, the proliferation of weapons of mass destruction" may trigger Form 10-Q/K disclosure requirements (and an accompanying "Iran Notice" filing under Section 13(r) of the Exchange Act) for some companies importing products to Russia.

Reminder: SEC Rule Amendments to MD&A & Financial Disclosures Under Regulation S-K

The SEC's amendments to MD&A and financial disclosure requirements under Regulation S-K became effective in February 2021, and companies are required to comply with these amendments beginning with the first fiscal year that ends after August 9, 2021. As such, December 31 year-end companies will not be required to comply with the amended rules until their annual reports on Form 10-K for the year ending December 31, 2021. Early voluntary compliance is permitted after the effective date if the company complies with the amended disclosure item in its entirety and in all applicable filings going forward. To date, for example, some companies have already chosen not to include selected financial data disclosures, as permitted by the amendments. For a summary of these changes, see our [January 2021 edition](#) of *Securities Quarterly Update*.

Holding Foreign Companies Accountable Act

The SEC's [interim final amendments](#) to implement the congressionally mandated disclosure requirements of the Holding Foreign Companies Accountable Act became effective on May 5, 2021. The amendments apply to companies that the SEC identifies as having filed an annual

report with an audit report issued by a foreign accounting firm that the Public Company Accounting Oversight Board is unable to inspect completely because of a position taken by a governmental authority in that jurisdiction.

To implement the amendments, Item 9C (Disclosure Regarding Foreign Jurisdictions that Prevent Inspections) has been added to Part II of Form 10-K. Item 9C requires subject companies to electronically provide to the SEC "on a supplemental basis documentation that establishes that the [company] is not owned or controlled by a governmental entity in the foreign jurisdiction." While it is not applicable to most companies, all companies will need to remember to list the new Item 9C in their Forms 10-K.

Recent SEC Enforcement Actions

Cybersecurity Disclosure Controls

On June 15, the SEC [announced](#) that it has settled charges against a public company for alleged failure to maintain disclosure controls and procedures related to a cybersecurity vulnerability that exposed sensitive customer information. Noting that such disclosure controls are "designed to ensure that all available, relevant information concerning a vulnerability was analyzed for disclosure in the company's public reports filed with the Commission," the SEC found that the company's senior executives "were not apprised of certain information that was relevant to their assessment of the company's disclosure response to the vulnerability and the magnitude of the resulting risk."

In summary, while the company filed a Form 8-K, the SEC alleged that the company's senior executives were not informed of the vulnerability that the company's information security personnel identified several months earlier. The company agreed to a cease-and-desist order for violating Rule 13a-15(a) of the Exchange Act and a monetary penalty.

This enforcement action is a reminder to implement and assess cyber-related disclosure controls and procedures rules and to conduct related employee training. Note also that this enforcement action involves a cybersecurity "vulnerability" as opposed to a cybersecurity breach.

Cybersecurity Risk Factors

In June, the Ninth Circuit [held](#) that a company's disclosure of cybersecurity risk may be misleading if the risk factor is hypothetical (that is, if the risk (e.g., a cyber breach or vulnerability) had already occurred but the risk factor only described potential consequences without disclosing the actual occurrence). In particular, statements about "no material changes" to risk factors in Forms 10-Q were at issue as they potentially made prior disclosures misleading. It is yet another reminder to review and update risk factors, as needed, with a view toward prior disclosures and recent developments with the company.

SolarWinds-Related Cybersecurity Information Requests

In June, many companies received voluntary information requests relating to the [2020 SolarWinds cyber breach](#), offering limited amnesty for the SolarWinds-related incidents, but also seeking information about other cyber compromises. On June 25, the SEC's Division of Enforcement issued some [guidance](#) to assist companies in responding to these inquiries.

When preparing disclosures regarding cybersecurity risks and incidents, consider the SEC's [Statement and Guidance on Public Company Cybersecurity Disclosures](#).

Confidentiality Provisions in Employee Handbooks

In June, the SEC [issued an order](#) announcing settled charges against a broker-dealer regarding alleged violations of a whistleblower protection rule under the Dodd-Frank Act that prohibits impeding employees from communicating with the SEC about possible securities law violations. The SEC's order found that the employee handbook prohibited employees from initiating contact with any regulatory agencies, including the SEC, without prior approval from the broker-dealer's legal or compliance department and that employee training materials included similar language.

It is yet another reminder for companies to review their employment agreements, confidentiality agreements, codes of ethics and conduct, employee handbooks, other company policies, and employee training materials on a regular basis.

FOR MORE INFORMATION

For more information, please contact a member of our [Securities, Capital Markets & Corporate Governance](#) team.

For ESG matters, please contact a member of our [ESG Collaborative](#).

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