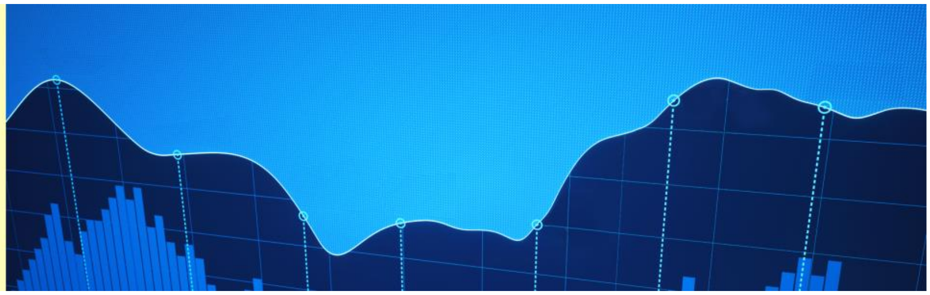

Securities Quarterly Update

October 2023 | 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 the SEC's recent rulemaking, certain enforcement activity, the latest ESG regulatory activity, some Nasdaq rule changes, recent developments impacting quarterly and other SEC reports, and certain regulatory developments that could be of interest to audit committees.*

Form 10-Q Considerations

MD&A

Disaggregation of the underlying factors for changes in the results of operations may be worth another look. Some recent SEC comment letters have also asked for additional disclosures on the impact of inflation, both in a narrative form and with quantification. In addition, the SEC has issued a number of comments relating to banks' liquidity disclosures, as reported by The Wall Street Journal.

Litigation Disclosures

Companies may want to revisit their litigation disclosures. While it is common to express the company's intent to defend the litigation vigorously and refer to it being "without merit," the Massachusetts Federal District Court's finding in *City of Fort Lauderdale Police & Firefighters' Ret. Sys. v. Pegasystems Inc.* serves as a reminder to carefully evaluate factual circumstances as to "merit."

Audit Committees

Consider reviewing the following developments with the audit committee.

Internal Control Over Financial Reporting – Comprehensive Risk Assessment

In late August 2023, the SEC's Chief Accountant issued a statement on the importance of a comprehensive risk assessment when evaluating the effectiveness of a company's internal controls. The SEC staff is "troubled by instances in which management and auditors appear too narrowly focused on information and risks that directly impact financial reporting, while disregarding broader, entity-level issues that may also impact financial reporting and internal controls." The statement calls for management to take a "holistic approach when assessing information about the business and avoid the potential bias toward evaluating problems as isolated incidents, in order to timely identify risks, including entity-level risks" and for "design [of] processes and controls that are responsive to identified risk." Some examples are included.

PCAOB Developments – NOCLAR

In June 2023, the Public Company Accounting Oversight Board (PCAOB) issued proposed "Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations" (NOCLAR) for public comment. The proposal would significantly expand auditors' responsibilities in identifying laws and regulations applicable to the company that could reasonably have a material effect on the company's financial statements and in assessing incidents of noncompliance. In return, auditors would most likely request significantly more information from companies relating to any laws and regulations potentially applicable to them, including in the ESG area, driving up audit costs.

FASB Developments – Tax Disclosures

As reported by The Wall Street Journal, in late August 2023, the Financial Accounting Standards Board (FASB) tentatively approved its proposed Accounting Standards Update (ASU), "Improvements to Income Tax Disclosures." More information is available here. Per the PCAOB's discussions, the amendments will be effective for public companies for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Private companies have another year.

10b5-1 Trading Plan Disclosures – New SEC CDIs

Recent SEC Rule 10b5-1 Changes

As a reminder, on December 14, 2022, the SEC adopted several amendments with respect to Rule 10b5-1 trading plans and the new disclosure requirements associated with such plans. As part of the amendments, companies are required to provide Form 10-Q and Form 10-K disclosures regarding the adoption, termination or modification, and certain material terms of any Rule 10b5-1 or certain other trading arrangements by their directors and officers. These disclosures are required to be iXBRL-tagged. Non-smaller reporting companies with calendar year-ends are already required to provide these disclosures, while smaller reporting companies with calendar year-ends will first be required to provide these disclosures in their Form 10-K filings for the year ending December 31, 2023. For additional information, see our alert dated December 15, 2022.

Latest SEC CDIs

On May 25 and August 25, 2023, the SEC's Division of Corporation Finance issued Compliance and Disclosure Interpretations (CDIs), which provide guidance regarding the transition timing for compliance with the new quarterly and annual disclosure requirements for Rule 10b5-1, insider trading and certain compensation disclosures, 10b5-1 trading arrangements covering securities in which an officer or director has a pecuniary interest, certain exceptions for overlapping Rule 10b5-1 plans, Rule 10b5-1 plan expirations, and counting rules for cooling-off periods.

The CDIs also clarify that the Rule 10b5-1 check box on Form 4 applies only to transactions that are made pursuant to Rule 10b5-1 plans that are intended to satisfy the conditions of *amended* Rule 10b5-1(c) (and not to Rule 10b5-1 trading plans that were adopted prior to the effective date of the amendments to Rule 10b5-1).

New SEC Rule Reminders

Cybersecurity Disclosures

On July 26, the SEC adopted final rules requiring certain cybersecurity-related disclosures. The new rules are intended to "enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance and incidents by public companies." Annual disclosures will be required for annual reports on Form 10-K for fiscal years ending on or after December 15, 2023, and the Form 8-K requirements will become effective mid-December 2023. For more information, see our alert dated July 27, 2023.

Clawbacks

On June 9, 2023, the SEC approved the new listing standards proposed by NYSE and Nasdaq, which require listed companies to adopt a written clawback policy; failure to do so, or to enforce any required clawback, could result in delisting from the stock exchange. For more information, see our alert dated November 8, 2022.

The new clawback listing standards become effective for incentive compensation received on or after October 2, 2023, and listed companies are required to adopt a compliant clawback policy by December 1, 2023.

In adopting a clawback policy, companies should consider related contractual and enforceability issues, the scope of the policy in light of any existing policies that the company may have, and the guidelines and pilot program issued by the Department of Justice and corresponding changes to the compensation committee charter and related policies.

NYSE-listed companies will be required to confirm the adoption of the clawback policy by December 1 with NYSE.

Pay-Versus-Performance and Non-GAAP Measures in CD&A – New SEC Guidance

On September 27, 2023, the SEC's Division of Corporation Finance issued CDIs providing guidance regarding pay-versus-performance disclosures as well as the following CDI regarding non-GAAP financial measures in the Compensation Discussion and Analysis (CD&A) section of the proxy statement:

Instruction 5 to Item 402(b) is limited to CD&A disclosure of target levels that are non-GAAP financial measures. If non-GAAP financial measures are presented in CD&A or in any other part of the proxy statement for any other purpose, such as to explain how pay is structured or implemented to reflect the registrant's or a named executive officer's performance or to justify certain levels or amounts of pay, then those non-GAAP financial measures are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K (except with regards to the Company-Selected Measure or additional financial performance measures disclosed pursuant to Item 402(v)(2)(vi) of Regulation S-K).

In these pay-related circumstances only, the staff will not object if a registrant includes the required GAAP reconciliation and other information in an annex to the proxy statement, provided the registrant includes a prominent cross-reference to such annex. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, the staff will not object if the registrant complies with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information.

SEC Fee Rate Increase

The SEC's fee rate will increase from $110.20 per million dollars to $147.60 per million dollars, effective October 1, 2023. For more information, see the SEC's announcement.

Proposed EDGAR Changes – SEC Filing System

In September 2023, the SEC proposed technical amendments relating to its EDGAR filing system. "The proposed amendments would further secure login protocols by requiring every person filing something into EDGAR to login with individual credentials and to use multi-factor authentication," said SEC Chair Gary Gensler. If these amendments are adopted in their proposed form, each company or another EDGAR filer will also have to have individual account administrators to manage the filer's EDGAR account on a newly created dashboard. Forms for SEC filing codes (i.e., Form ID) would change for the amended process. It could be quite administratively burdensome.

Sample SEC Comment Letter to Companies Regarding XBRL

In September 2023, the SEC's Division of Corporation Finance issued a public comment letter regarding XBRL tagging in SEC filings. The guidance notes some common errors and includes some sample comments relating to tagging of the cover page, the financial statements, and the proxy pay-versus-performance disclosure.

Sample SEC Comment Letter to Companies Regarding China-Specific Disclosures

In July 2023, the SEC's Division of Corporation Finance issued an additional public comment letter regarding China-related disclosure issues, including supply chain exposure. Among other things, the guidance advises companies to consider their disclosures in light of the Uyghur Forced Labor Prevention Act (UFLPA) "with a view towards providing investors with tailored disclosure about the material impacts of the provisions of this statute on their business," which "may include material compliance risks or material supply chain disruptions that companies may face if conducting operations in, or relying on counterparties conducting operations in, the Xinjiang Uyghur Autonomous Region."

SEC Statement Regarding Potential Government Shutdown

On September 27, the SEC's Division of Corporation Finance issued a statement regarding a potential government shutdown. The statement includes reminders that should a government shutdown occur, the Division's activities would be "extremely limited" and that "the Division [would] not be able to accelerate the effectiveness of registration statements." EDGAR would remain open. The statement also includes additional guidance for offerings, shareholder proposals and preliminary proxy statements.

Schedules 13D/G and Forms 3/4/5 – SEC Enforcement Actions

In September 2023, the SEC announced charges against certain officers, directors, and greater than 5% shareholders of public companies for alleged failures to file timely beneficial ownership reports on Form 4 and Schedules 13D and 13G relating to their stock holdings and transactions in the company's securities. For example, some charges relate to the alleged failures to file Schedule 13D amendments "caused by both increases in the number of outstanding [company] shares and dispositions of beneficial ownership initiated by [the holder]," as well late initial Schedule 13D/G filings and late Forms 4. Insiders are generally deemed to have responsibility for their Schedule 13D/G and Section 16 filings.

However, the SEC also charged the companies "for contributing to the filing failures by insiders or failing to report their insiders' filing delinquencies." As an example, the SEC found the company negligent where "[t]he procedures and practices employed by [the company] were insufficient to the extent that those practices resulted in the recurrent failure to meet the two-business day filing deadline." "These enforcement actions also make clear that we will not hesitate to charge companies for causing their insiders' disclosure violations where the companies took on the responsibility for making relevant filings for their insiders, and then acted negligently," said Gurbir S. Grewal, Director of the SEC's Director of Enforcement.

Even inadvertent failures to file still constitute violations, and the SEC's investigations in this area are "ongoing."

Rule 12b-25 "Notification of Late Filing" – SEC Enforcement Actions

Form 12b-25 "Notification of Late Filing"

When seeking a (15/5-calendar day) extension to file an annual report on Form 10-K or a quarterly report on Form 10-Q due to the inability to file the report timely, a Form 12b-25 is required to be filed within one business day after the due date of the applicable Form 10-K/Q. Among other things, the Form 12b-25 requires a description of the reasons for the inability to file timely and to indicate if the company expects that any significant change in its results of operations from the corresponding period for the prior fiscal year will be reflected in the report. If so, a narrative and quantitative explanation of the expected change is required in the Form 12b-25 or, in appropriate cases, an explanation of the reasons why the results cannot be reasonably estimated.

Recent SEC Enforcement Actions

In August 2023, the SEC announced settlements of enforcement actions against five companies for failing to disclose in their Forms 12b-25 that their request for seeking a delayed filing of their Forms 10-K/10-Q was caused, among other things, by an anticipated restatement or other revision of prior financial reporting and for allegedly failing to disclose that management anticipated significant changes in results of operations. In April 2021, the SEC charged eight companies for similar violations.

Companies should carefully consider their timelines and available information when preparing their Form 12b-25 disclosures.

Related Party Disclosures – SEC Enforcement Actions

Per the SEC's announcement in September 2023, a public company paid a $500,000 penalty, without admitting or denying the SEC's allegations, for not disclosing that it employed the siblings of one of its executives following the executive's promotion. The siblings' compensation exceeded the SEC's $120,000 threshold for the proxy disclosure of related person transactions. Note that the disclosure threshold can be lower for smaller reporting companies and that, in some cases, companies may decide to disclose amounts below these thresholds. Consider revising procedures for tracking transactions with related persons, particularly in connection with officer and director changes.

Confidentiality Provisions – SEC Enforcement Actions

The SEC continues its enforcement activity relating to confidentiality and other provisions that could be deemed to run afoul of its whistleblower rules (such as waivers of monetary incentives, restrictions on filing claims with government agencies, etc.). Consider if employee agreements and company policies should be reviewed with this in mind.

Recent Changes for Nasdaq-Listed Companies

Reverse Stock Split and Other Notifications

Nasdaq has recently revamped its notification forms, so the look and some of the information requested may be different than the last time the notice was submitted. Nasdaq-listed companies may want to allocate some additional time to prepare these notifications.

Nasdaq has also issued proposed amendments relating to reverse stock split notifications, proposing (i) a required notification to Nasdaq at least five business days (no later than 12:00 p.m. ET) prior to the anticipated market effective date (which is less notice than is currently required), (ii) a copy of the company's draft public disclosure to be provided to Nasdaq within the same time frame, (iii) a company's public disclosure about the reverse stock split at least two business days prior to the proposed effective date of the reverse stock split (which is an earlier public disclosure than currently required), and (iv) notice of such disclosure to Nasdaq's MarketWatch (at least 10 minutes prior to public announcement if the public release of the material information is made between 7:00 a.m. and 8:00 p.m. ET).

Code of Conduct Waivers

Nasdaq has also proposed amendments relating to waivers to the code of conduct, which were published by the SEC and became effective in September 2023. Following this change, waivers to directors and officers could be provided by a board committee as opposed to the full board. Accordingly, some Nasdaq-listed companies may want to amend their codes of conduct and applicable committee charters.

ESG Update

The SEC's final climate disclosure rule continues to be tentatively scheduled for October 2023. Several anti-ESG bills have been introduced in Congress, including the GUARDRAIL Act (H.R. 4790), which would, among other things, provide that SEC disclosures are necessary only "to the extent the issuer has determined that such information is material with respect to a voting or investment decision regarding the securities of such issuer."

In the meantime, the California Legislature passed two bills relating to climate risk and emissions disclosures that could impact thousands of public and private companies "doing business in California" and meeting overall revenue thresholds on a company-wide basis. The Climate-Related Financial Risk Act would require companies to report biennially on climate-related financial risk and the Climate Corporate Data Accountability Act would require companies to publicly disclose their scope 1, 2 and 3 greenhouse gas emissions. For more information, see our alert dated September 15, 2023.

For companies mapping out "the next ESG focus areas," while the activity in the United States has been largely focused on climate change, international developments also foreshadow the focus on the nature- and biodiversity-related impacts, recycling and circular economy, and deforestation. For example, In September 2023, the Taskforce on Nature-related Financial Disclosures (TNFD) (not to be confused with TCFD for voluntary climate disclosures) published its final disclosure framework, which can be used as guiding principles for nature-related disclosures.

FOR MORE INFORMATION

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