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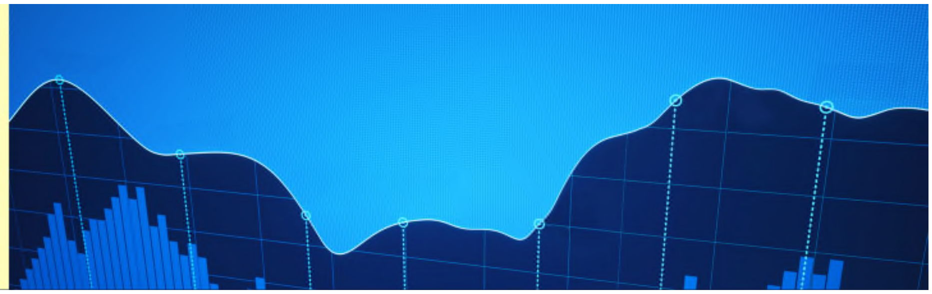

Securities Quarterly Update

December 2024 | Second Winter Edition

Welcome to the winter edition of Securities Quarterly Update*, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at new disclosure requirements for the 2025 proxy season, recent SEC enforcement actions, and recent rule changes at Nasdaq and the NYSE.*

Select Considerations for Form 10-K and Proxy Statements

Insider Trading Policies and Procedures

Beginning in 2025, calendar year end reporting companies will be required to include narrative disclosures describing their insider trading policies and procedures in their annual reports on Form 10-K and proxy statements, and will be required to file their insider trading policy as an exhibit to the Form 10-K. Item 408(b) of Regulation S-K requires a company to disclose whether it has adopted insider trading policies and procedures governing the purchase, sale, or other dispositions of its securities by directors, officers, employees, or the company itself, that are reasonably designed to promote compliance with insider trading laws and, if not, an explanation why. This disclosure is required to be Inline XBRL tagged. The disclosure may be incorporated by reference from the proxy statement into the Form 10-K if the proxy statement is filed within 120 days of a company's fiscal year-end. Any insider trading policy will generally need to be included as an exhibit to the Form 10-K.

Companies should review their insider trading policies to ensure they comply with applicable laws, including the 2023 amendments to Rule 10b5-1 of the Exchange Act, and address recent enforcement actions, such as "shadow" trading, where transactions are made in a company's securities based on material nonpublic information (MNPI) about another company. Companies should also review how and where company stock repurchases are addressed. Consider if any updates to such policies are needed, particularly given the SEC's recent regulatory and enforcement activity.

Policies and Practices Related to the Grant of Equity Awards Close in Time to the Release of Material Nonpublic Information

Item 402(x) of Regulation S-K will now require narrative and tabular disclosure of the timing of awards of stock options and stock appreciation rights (SARs) relative to the disclosure of MNPI. The narrative disclosure is required to describe any policies and practices regarding the timing of such equity awards, including how the board of directors determines when to grant such an award, whether the board takes MNPI into consideration when determining an award, and, if so, how, and whether the company has timed the disclosure of MNPI to affect the value of executive compensation.

In addition, if, during the last completed fiscal year, the company awarded options or SARs to any named executive officer (NEO) in the period four business days before to one business day after the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a current report on Form 8-K that discloses MNPI, the company is required to disclose the following in tabular form: the name of the NEO, the grant date of the award, the number of securities underlying the award, the per-share exercise price of the award, the grant date fair value of the award using the same methodology used for the company's financial statements under GAAP, and the percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of MNPI and the trading day beginning immediately following the disclosure of MNPI

This disclosure is required to be Inline XBRL tagged.

Also consider the SEC's guidance regarding compensation recovery (clawback) disclosures and related Form 10-K check boxes and SEC commentary regarding pay versus performance disclosures. If a company is required to check the second box, indicating that an error correction was a restatement that required a recovery analysis of incentive-based compensation, it is required to provide disclosure regarding the recovery analysis, or an explanation of why recovery was not required, and such disclosure is also required to be Inline XBRL tagged.

Cybersecurity Disclosures in Form 10-K

Item 1C cybersecurity disclosures in annual reports on Form 10-K should be updated for developments since the last disclosure. Similarly, companies should review related risk factors and proxy board oversight disclosures. Companies may also want to consider if the oversight of artificial intelligence (AI) and related risks and opportunities should be addressed and, if so, to what degree. Note also that Item 1C cybersecurity disclosures will now be required to be Inline XBRL tagged.

Segment Reporting

Note that new accounting standards are in effect that require additional information about company segments, including where the company only has one segment. Companies should consider related MD&A and non-GAAP matters that could be implicated and advise their audit committees accordingly.

The Re-Election of President Donald Trump

Companies should consider the potential impact the incoming presidential administration may have on their businesses, specifically as it relates to tariffs, supply chains, environmental, social and governance (ESG) policies and human capital, including diversity, equity and inclusion (DEI) programs, and whether any updates to their Business section, Risk Factors, MD&A, and/or Forward-Looking Statements are necessary.

Disclosure of Cybersecurity Incidents on Item 1.05 of Form 8-K

Recent SEC comment letters provide some guidance on how to report cybersecurity incidents on Item 1.05 of Form 8-K. For example, in July 2024, a company reported on Item 1.05 a cybersecurity incident in which a threat actor unlawfully accessed and copied the company's call logs. In its Form 8-K, the company stated that "the incident has not had a material impact on [its] operations, and [the company] does not believe that this incident is reasonably likely to materially impact [its] financial condition or results of operations."

In its initial comment letter, the Staff noted that "the rule's inclusion of 'financial condition and results of operations' is not exclusive; companies should consider qualitative factors alongside quantitative factors in assessing the material impact of an incident. For example, consider impacts on customer relationships, competitiveness, and potential reputational harm." In its response, the company distinguished between whether an incident is "material" or "likely to have a 'material impact'" on the company, and indicated that it considered "material" to be broader than "material impact." Taking into consideration both qualitative and quantitative factors, the company concluded that the breach was "material" as information about the incident would "significantly alter the total mix of information" available to investors and would be "important in making a voting or investment decision."

In its close of review letter, the SEC did not opine on the legality of the company's disclosure but noted "[i]t appears inconsistent to conclude that an incident is material because of 'reputational and customer perception risks associated with the incident' but that the incident has not had, and is not reasonably likely to have, any material impacts on the company, including with respect to the company's reputation and customer perception."

Consider incorporating into disclosure procedures structures for making determinations whether a cybersecurity incident should be reported under Item 1.05 or Item 8.01 of Form 8-K.

Director and Officer Questionnaires

Companies should consider updating their Director and Officer Questionnaires to account for certain points of interest from the SEC, institutional investors, and from recent SEC enforcement actions. Please see our client alert *Updates to 2025 Director and Officer Questionnaires*.

Leadership Changes at the SEC

On November 21, 2024, SEC Chair Gary Gensler announced that he would step down effective at 12:00 p.m. on January 20, 2025. President-elect Donald Trump has chosen Paul Atkins, a former SEC commissioner and proponent of cryptocurrency, to succeed Gensler as Chair.

ESG

General Update

Given changes at the SEC, it is anticipated that the SEC's climate disclosure rule, as well as additional board diversity and human capital disclosure proposals, are unlikely to come into force. While many will undoubtedly breathe a sigh of relief, this may create some new challenges when managing ESG disclosures required in other parts of the world or at the state- and local-level. Companies may want to be particularly careful in their ESG "materiality" assessments.

State- and local-level activity on ESG topics remains difficult to assess at this time (but note, for example, that the California Air Resources Board recently announced some enforcement relief relating to reporting of greenhouse gas (GHG) emissions and issued a request seeking comments as to its implementation of the California climate disclosure laws).

It is further anticipated that it may become more difficult for shareholder proponents to submit shareholder proposals for inclusion in company proxy statements, particularly on environmental and social issues. On one hand, this may create some additional avenues for companies to seek no-action relief from the SEC. On the other hand, this may lead to shareholder proponents exploring non-traditional avenues such as proxy contests, "vote no" campaigns against directors and litigation.

Companies should evaluate any actions in the ESG area with the company's shareholder base, industry, employees and customers in mind. Greenwashing (on environmental issues) and bluewashing (on social issues) claims remain an area of concern, and ESG disclosure regulations and litigation are increasing on a global basis.

Federal Appeals Court Invalidates SEC's Approval of Nasdaq Board Diversity Rule

On December 11, 2024, the Fifth Circuit Court of Appeals ruled that the SEC did not have the authority to approve Nasdaq's board diversity rule, which required listed companies to disclose information about directors' ethnicity, gender identity, and sexual orientation. The rule also required companies to have at least two diverse directors, one female and one who self-identifies as an underrepresented minority, or provide an explanation for not doing so.

Nasdaq subsequently notified listed companies that it did not intend to pursue any further review. As such, companies will have the option to remove Nasdaq diversity tables from their proxy statements and/or company websites or to retain them on a voluntary basis.

SEC EDGAR Updates

Reminder – New Structured Data Requirement for Schedules 13D & 13G

Beginning December 18, 2024, companies will be required to use a structured data format, specifically XML, for Schedule 13D and Schedule 13G filings to improve the accessibility and usability of the disclosures. Note that these changes will require some restructuring and reformatting of Schedule 13D/G disclosures, so some additional time may be needed to prepare and process the first filing with these changes.

Transition to EDGAR Next

As discussed in our Fall 2024 *Securities Quarterly Update*, the SEC adopted amendments (EDGAR Next) to modernize and enhance the security of EDGAR. Beginning September 15, 2025, compliance with EDGAR Next will be required to make filings with the SEC. To facilitate a smooth transition, individuals who plan to make or assist a company with its SEC filings should consider obtaining individual account credentials at Login.gov and accessing the EDGAR Next Adopting Beta Environment to gain familiarity with its functionality and user interface. Some coordination with individual filers, other companies where they serve on the board of directors or as officers, and filing agents will be necessary.

Stock Exchange Updates – Reverse Stock Splits and Penny Stock

Nasdaq Requires Further Advance Notice of Reverse Stock Splits

In 2023, Nasdaq adopted rule changes related to notification and disclosure of reverse stock splits, which, among other things, required companies to provide notice of the split to Nasdaq no later than 12:00 p.m. ET five business days prior to the proposed effective date. Nasdaq has now amended such deadline from five business days to 10 calendar days. Companies will be required to comply with the new deadline as of January 30, 2025. Companies are still required to provide public disclosure of a reverse split at least two business days (no later than 12:00 p.m. ET) prior to the market effective date.

For illustration, the notice of proposed rule change includes the following example (which presumes no holidays): If a company desires to effect a reverse stock split with a market effective date of Monday, September 23, the company would have to provide Nasdaq with a draft of the disclosure required by proposed Rule 5250(b)(4) and a complete Company Event Notification Form by 12:00 p.m. ET on Friday, September 13, and provide the public disclosure by 12:00 p.m. ET by Thursday, September 19.

Amendments to Nasdaq's Compliance Periods for Minimum Bid Price Deficiencies

In October 2024, the SEC approved a Nasdaq rule change that impacts the period for regaining compliance with the minimum bid price requirement (i.e., that companies maintain a closing bid price that is no less than $1.00 per share). Under the new rules, where a company takes action to regain compliance with the bid price requirement (such as a reverse stock split), and such action results in non-compliance with a different listing requirement (such as the number of publicly held shares or public holders), the company will continue to be considered non-compliant with Nasdaq's listing requirements until **both** the new deficiency is cured and, thereafter, the company meets the $1.00 bid price requirement for at least 10 consecutive business days (which may be extended at Nasdaq's discretion). If the company does not regain compliance with both the bid price deficiency and the other deficiency during the initial compliance period applicable to the bid price deficiency, then Nasdaq will issue a delisting determination letter. Prior to the rule change, such companies could receive an additional grace period to regain compliance with the new deficiency.

NYSE Proposal Would Restrict the Use of Reverse Stock Splits to Regain Price Compliance

On October 10, 2024, the NYSE proposed restrictions to the use of reverse stock splits to regain compliance with its minimum price criteria rule, which provides that a company is below compliance standards if the average closing price of a security as reported on the consolidated tape is less than $1.00 over a consecutive 30 trading-day period (Price Criteria). The NYSE proposal would amend Section 802.01C of the NYSE Listed Company Manual to provide that, if a company's security fails to meet the Price Criteria and (i) the company has effected a reverse stock split over the prior one-year period or (ii) has effected one or more reverse stock splits over the prior two-year period with a cumulative ratio of 200 shares or more to one, then the NYSE will immediately commence suspension and delisting procedures. The proposal would also preclude a company from effectuating a reverse stock split if it would result in the company's security falling below the continued listing requirements of Section 802.01A. The proposal is intended to protect investors by resulting in the delisting of companies whose history of recurring inability to maintain compliance with the Price Criteria is a sign of financial instability or operational distress and unsuitability for continued listing. The proposed rule changes have not yet been approved by the SEC.

Nasdaq Seeks to Expedite the Delisting Process for Penny Stocks

Nasdaq's current listing rules allow a company to potentially receive up to 540 days to regain compliance with Nasdaq's minimum bid price requirement, subject to certain exceptions. Companies have an initial automatic 180-day period to regain price compliance before facing delisting, and Nasdaq may give companies an additional 180 days to regain compliance if they comply with certain requirements. After exhausting the applicable compliance period and receiving a delisting determination, companies can then appeal such determination to the Nasdaq Listing Qualification Hearings Panel, which can provide up to an additional 180 days to regain compliance.

Nasdaq recently proposed amendments to expedite the delisting process for penny stocks. Under the proposed rules, a company that has not been in compliance with the $1.00 bid price requirement for more than 360 days would be immediately suspended from trading on Nasdaq regardless of any ongoing appeal process. In addition, a company that falls below the bid price requirement and has effected a reverse stock split within the past year would not receive the initial automatic 180-day compliance period and would be immediately delisted. The proposed rule changes have not yet been approved by the SEC.

FASB Adopts New Reporting Standards Requiring Disaggregation of Expenses

On November 4, 2024, FASB issued ASU 2024-03 requiring public companies to disclose additional information about certain expenses in the notes to financial statements. The amendments require that at each interim and annual reporting period a company must:

- Disclose the amounts of (a) purchases of inventory, (b) employee compensation, (c) depreciation, (d) intangible asset amortization, and (e) depreciation, depletion, and amortization recognized as part of oil- and gas-producing activities (or other amounts of depletion expense) in each relevant expense caption presented on the income statement.
- Include certain amounts that are already required to be disclosed under GAAP in the same disclosure as the other disaggregation requirements.
- Disclose a qualitative description of the amounts remaining in relevant expense captions presented on the income statement that are not separately disaggregated quantitatively.
- Disclose the total amount of selling expenses and, in annual reporting periods, an entity's definition of selling expenses.

The amendments will go into effect for annual reporting periods beginning after December 15, 2026, and interim reporting periods beginning after December 15, 2027.

Select Recent SEC Enforcement Actions

SEC Disclosures Regarding Regulatory Developments

The SEC has charged a company and two former executives for allegedly failing to disclose that its two cancer fighting drug candidates had been placed on clinical hold by the Food and Drug Administration (FDA) leading up to and during its July 2021 follow-on offering that raised $40 million.

According to the SEC's order, two weeks before its follow-on offering, the FDA notified the company that it had placed its two drug candidates on clinical holds. The company did not disclose the FDA clinical holds in its registration statement, quarterly report, investor roadshows, or due diligence calls leading up to the follow-on offering, even though it disclosed the hypothetical risk of a clinical hold and its potential adverse consequences. In light of this order, companies should be diligent in evaluating and disclosing, as appropriate, material changes in the status of regulatory developments relating to their products and services.

Securities Fraud Charges Relating to Clinical Trial Results

In September 2024, another pharmaceutical company agreed to pay $40 million to settle charges with the SEC which alleged that the company made misleading statements about the results of its clinical trial for a drug candidate. The SEC also brought charges against two former company executives for presenting allegedly misleading data from the trial.

The complaint alleged the company misled investors by claiming that the drug candidate "significantly improved patient cognition" when the full clinical trial data set showed no measurable improvement in patients' memory and for failing to disclose the consulting medical professor's conflict of interest. The SEC also charged that the company made misleading statements that its clinical trial was conducted in blinded conditions despite the fact the medical professor had been unblinded. As part of the settlement, former company executives agreed to pay fines ranging from $85,000 to $175,000 and to be subject to officer-and-director bars ranging from three to five years.

Insider Trading Ahead of Negative Earnings Announcement

On December 11, 2024, the SEC announced it charged a former company executive for insider trading in connection with his sale of company shares on the basis of material non-public information with respect to the company's anticipated negative quarterly earnings results. The SEC alleged that the former executive received a confidential presentation detailing the company's anticipated negative quarterly earnings results. Before the company announced its negative earnings results causing its stock to drop more than 25 percent, the executive allegedly placed an order to sell company stock and avoid $12,445 in potential losses. The complaint further alleges that the executive directed his financial advisor to sell additional company stock to avoid $110,000 in additional losses, but the financial advisor was unable to due to a trading blackout. This action is yet another reminder to build out a strong process for assessment of material non-public information and insider trading procedures.

Impairment Assessment

On November 22, 2024, the SEC settled charges against a shipping company for allegedly materially misrepresenting its earnings due to its failure to charge goodwill impairment on one of its worst performing business units (the "Freight Unit"). In 2019, the company conducted a valuation of the Freight Unit which was listed on its balance sheet at $1.4 billion. Following its internal valuation, the company concluded its Freight Unit could only sell for about $350 million to $650 million, which reflected that approximately $500 million of goodwill associated with the Freight Unit was impaired. However, when the company conducted goodwill impairment testing in accordance with GAAP, it allegedly ignored its own assessment of the Fright Unit's fair value and instead relied on estimates prepared by an external consultant. According to the SEC's order, to support its original valuation of its Freight Unit, the company withheld the information necessary for the consultant to fairly value the business unit. Based on financial information and assumptions provided and approved by the company, the consultant valued its Freight Unit at nearly $2 billion.

In 2020, the company decided to solicit offers for the sale of its Freight Unit which led to the execution of a non-binding term sheet with a prospective buyer to sell it for $800 million. However, when conducting goodwill impairment testing for 2020, the company again did not consider the proposed transaction when valuing the Freight Unit and the consultant again valued it at nearly $2 billion. In both 2019 and 2020, the company relied on this valuation of its Freight Unit in disclosures regarding the amount of its earnings, goodwill balances, and shareholders' equity. The SEC charged that those disclosures were materially misleading because they were predicated on the assumption that goodwill for its Freight Unit was unimpaired when in fact the company had reliable information that it was materially impaired. Companies should periodically revisit their procedures for impairments and related decision-making.

Disclosures Relating to Revenue Growth and Consumer Demand and the Role of Rebates, Discounts and Other Incentives

On November 12, 2024, the SEC announced it settled charges against a public company for failing to disclose the impact of its sales practices, allegedly rendering positive statements about revenue growth and consumer demand misleading. The SEC alleged that, from 2019 to 2020, the company relied on quarter end incentives in the form of rebates, discounts, and extended payment terms offered to distributors to meet internal revenue targets ("Incentivized Sales"). As a result, the company improved revenue each quarter, but caused distributors to purchase inventory in amounts that exceeded consumer demand. Publicly, the company allegedly attributed its revenue growth to strong consumer demand while failing to disclose both the impacts and risks associated with its Incentivized Sales.

The SEC alleged that the company "failed to disclose the significant impact of its Quarter-End Incentivized Sales and the reasonably likely risk that these sales practices could have a negative impact on revenue in future quarters." The SEC found the company failed to act reasonably or implement disclosures and procedures designed to ensure all material factors impacting revenue and revenue growth were disclosed.

As always, companies should carefully evaluate their back-up support for any statements relating to market size, revenue growth and product demand and develop disclosure committee procedures that encompass revenue recognition and related incentives. There has been a number of recent SEC enforcement actions relating to "forward pulling of revenues" without accompanying discussion of related strategies and impact in SEC filings.

Cybersecurity Disclosures

In October 2024, the SEC charged four companies with making allegedly misleading disclosures regarding cybersecurity risks in connection with the compromise of SolarWinds' Orion software. The SEC alleged that "each [of the companies] negligently minimized its cybersecurity incident in its public disclosures." For example, one of the companies "inaccurately described the existence of successful intrusions and the risk of unauthorized access to data and information in hypothetical terms, despite knowing that [] intrusions had actually happened and in fact involved unauthorized access and exfiltration of confidential and/or proprietary information." This serves as a reminder for companies to disclose — in risk factors and elsewhere — when a hypothetical risk has materialized.

FOR MORE INFORMATION

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