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The Securities and Exchange Commission -- Current Rulemaking Agenda

Robert Stebbins

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I. Securities and Exchange Commission – General

General

- The Securities and Exchange Commission (the "SEC" or the "Commission") employs approximately 4,500 people in its Washington, DC headquarters and its 11 regional offices.
- The SEC was formed as a response to the stock market crash of October 1929 and the following period of the Great Depression. One-half of the $50 billion in new securities offered during the 1920s became worthless.
- Following the stock market crash, Congress recognized that public confidence in the securities markets had plummeted and that, for the economy to recover, the public's faith in the capital markets needed to be restored.
- First, Congress passed the Securities Act of 1933 (the "Securities Act"), which was designed to regulate disclosure and truth in the purchase and sale of securities.
- Second, Congress passed the Securities Exchange Act of 1934 (the "Exchange Act"), which primarily regulates transactions of securities in the secondary markets, and which created the SEC. The SEC was tasked with enforcing the newly passed securities laws, promoting stability in the markets and protecting investors.
- Joseph Kennedy, John F. Kennedy's father, was the first chairman of the SEC.

SEC – General (cont.)

- The mission of the SEC is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."
- The SEC is controlled by five Commissioners appointed by the President. Each Commissioner serves a five-year term and the terms are staggered as to the individual Commissioners.
- One of the Commissioners is designated as the Chair by the President.
- By law, no more than three of the Commissioners can belong to the same political party.
- The structure creates some interesting dynamics.
- The Commission convenes on a regular basis and meetings are open to the public, unless the discussion pertains to a confidential subject, such as an enforcement investigation.

SEC – General (cont.)

- The SEC is responsible for overseeing the nation's securities markets and certain primary participants, including broker-dealers, investment advisers, clearing agencies, transfer agents, credit rating agencies, and securities exchanges.
- The SEC is responsible for overseeing the Financial Industry Regulatory Authority ("FINRA"), the Municipal Securities Rulemaking Board (the "MSRB") and the Public Company Accounting Oversight Board (the "PCAOB").
- Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), the agency's jurisdiction was expanded to include certain participants in the derivatives markets, private fund advisers and municipal advisors.

SEC – General (cont.)

- The SEC oversees, among other things:
  - approximately $115 trillion in securities trading annually on U.S. equity markets;
  - 24 national securities exchanges, more than 3,700 broker-dealers and seven active registered clearing agencies, the PCAOB, FINRA, the MSRB, the Securities Investor Protection Corporation and the Financial Accounting Standards Board; and
  - activities of over 28,000 registered entities.
- *See* SEC Fiscal Year 2021 Annual Report.
- These registered market participants include investment advisers, broker-dealers, transfer agents, municipal advisors, mutual funds and exchange-traded funds.

SEC – General (cont.)

- The U.S. capital markets are the deepest, most dynamic and most liquid in the world.
- This capital provides businesses with the opportunity to grow and create jobs and provides the U.S. economy with a competitive advantage.
- The U.S. population is approximately 4.2% of the global population, but 59 of the world's largest publicly traded companies are U.S. companies.
- These 59 companies represent 65% of the total market capitalization of those top 100 companies. See PWC Global, "Global Ranking of the Top 100 Public Companies by Market Capitalisation," March 2021.
- A record 67 million U.S. families held direct and indirect stock holdings in 2019. This level of retail participation stands out against other large industrialized countries.

SEC – General (cont.)

- The SEC is divided into six divisions and approximately 25 offices, each of which is headquartered in Washington, DC.
- The divisions are: (i) Corporation Finance, (ii) Enforcement, (iii) Trading and Markets, (iv) Investment Management, (v) Examinations and (vi) Economic and Risk Analysis.
- Among the approximately 25 offices at the SEC are:
  - (i) the Office of General Counsel,
  - (ii) the Office of the Inspector General,
  - (iii) the Office of International Affairs,
  - (iv) the Office of Ethics Counsel,
  - (v) the Office of the Investor Advocate,
  - (vi) the Office of Legislative and Intergovernmental Affairs,
  - (vii) the Office of the Chief Accountant,
  - (viii) the Office of the Strategic Hub for Innovation and Financial Technology,
  - (ix) the Office of the Whistleblower, and
  - (x) the Office of Administrative Law Judges.

II. Regulation Flex Agenda

- In June 2023, the Commission announced its Spring 2023 Unified Agenda of Regulatory and Deregulatory Actions (the "RegFlex Agenda"). *See* SEC, Agency Rule List (Spring 2023).
- The RegFlex Agenda sets forth the short-term and long-term regulatory actions that the SEC expects to consider in the next 12 months that are likely to have a significant economic impact on a substantial number of small entities. The current short-term RegFlex Agenda set forth 55 possible rules to be considered, 37 of which were at the final/adoption stage. Certain of these possible rules have subsequently been adopted in final form after issuance of the RegFLex Agenda, such as the Investment Company names rule, the money market rule and the cybersecurity rule.
- The short-term agenda items listed include:
  - reporting of securities loans,
  - Schedule 13D,
  - Rule 14a-8,
  - climate disclosures, and
  - securities-based swaps.

Reporting of Securities Loans

- On November 18, 2021, the SEC voted unanimously to propose a rule requiring any person or entity that loans a security (debt or equity) on behalf of itself or another person or entity to report the material terms of the transaction to FINRA. *See* Reporting of Securities Loans, Exchange Act Release No. 93613 (Nov. 18, 2021).
- The value of securities on loan in the United States as of September 30, 2021 was estimated at approximately $1.5 trillion.
- Broker-dealers are the primary borrowers of securities; broker-dealers that borrow securities typically re-lend those securities or use the securities to cover fails-to-deliver or short sales arising from proprietary or customer transactions.
- Securities lending transactions are usually facilitated by a third-party agent such as a custodian bank, who lends securities on behalf of its custodial clients for a fee.
- The beneficial owners of the securities being loaned are generally large institutional investors, including investment companies, sovereign wealth funds, pension funds, collective investment trusts, and insurance companies.
- Section 984 of the Dodd-Frank Act provides the Commission with the authority to increase transparency with respect to the loan or borrowing of securities. Note that as this section of the Dodd-Frank Act pertains to the loan or borrowing of securities, the proposed rule does not address repurchase agreements.

Reporting of Securities Loans (cont.)

- For purposes of the proposed rule, a “Lender” is defined to include persons or entities that own the securities being loaned (“beneficial owners”), as well as third party intermediaries, including banks, clearing agencies, or broker-dealers that intermediate the loan of securities on behalf of beneficial owners (each, a “Lending Agent”).
- A “Lender” would not include the borrower of securities in a securities loan transaction or any third party that intermediates the borrowing of securities on behalf of the borrower. Thus, the borrower would not be obligated to provide any information to FINRA pursuant to the Proposed Rule.
- If the beneficial owner is using an intermediary Lending Agent for the securities loan, the Lending Agent would have the obligation to provide information, on behalf of the beneficial owner, to FINRA pursuant to the Proposed Rule. The beneficial owner of the security would only be required to provide information to FINRA pursuant to the Proposed Rule if such beneficial owner does not use an intermediary Lending Agent for the securities loan.
- If the beneficial owner or a Lending Agent is obligated, as a Lender, to provide this information to FINRA, such Lender may contract with a broker-dealer as “reporting agent” to provide the information to FINRA on its behalf.

Reporting of Securities Loans (cont.)

- Public Data. Within 15 minutes after each loan is effected or modified, the Lender would be required to provide FINRA with certain information as to such transaction that FINRA will make publicly available, including (i) the name of the issuer, (ii) the amount of the security loaned, (iii) the type of collateral, (iv) certain fee information and (v) the percentage of collateral to value of loaned securities.
- Confidential Data. Within 15 minutes after each loan is effected, the Lender would also be required to provide FINRA with certain information as to such transaction that FINRA will keep confidential (the information would be shared with the Commission and such other persons as the Commission may designate upon a demonstrated regulatory need), including (i) the name of each party to the transaction, (ii) if the person or entity lending the securities is a broker-dealer and the borrower is its customer, information about whether the security is loaned from the broker-dealer's inventory, and (iii) whether the loan is being used to close out a fail-to-deliver (if the Lender has such information).

Reporting of Securities Loans (cont.)

- Aggregate Data. A beneficial owner or its Lending Agent, as applicable, would also be required to provide FINRA with certain other information by the end of each business day on which the beneficial owner had an open securities loan as to which the Lender was required to provide information to FINRA pursuant to the proposed rule as described above, including: (i) the total amount of the applicable security available to be lent by the beneficial owner or its Lending Agent, as applicable, and (ii) the total amount of the applicable security on loan that has been contractually booked and settled.
- If the Lending Agent is a broker-dealer, items (i) and (ii) would include any such securities owned by the broker-dealer, any such securities in its margin customer's accounts and any such securities owned by its customers who have agreed to participate in a fully paid lending program.
- FINRA would be required to aggregate any information it receives under items (i) and (ii) above and to make public aggregate information for that security no later than the next business day.
- Public access to the securities lending information would be available on FINRA's website or similar means of electronic distribution and would be free and without use restrictions. Costs for establishing and maintaining this system would be borne by FINRA in the first instance and would be recouped by FINRA from market participants that report securities lending transactions to FINRA.

Schedule 13D

- On February 10, 2022, the Commission voted 3-1 to propose changes to the beneficial ownership reporting requirements under the Exchange Act. *See* Modernization of Beneficial Ownership Reporting, Exchange Act Release No. 94211 (Feb.10, 2022).
- The proposed amendments would: (i) revise the current deadlines for Schedule 13D and Schedule 13G filings; (ii) amend Rule 13d-3 to deem holders of certain cash-settled derivative securities as beneficial owners of the reference covered class; (iii) clarify and affirm the operation of Schedule 13D as applied to two or more persons that form a group under the Exchange Act; and (iv) set forth the circumstances under which two or more persons may communicate and consult with one another and engage with an issuer without becoming subject to regulation as a group with respect to the issuer's equity securities.
- <u>Filing Deadlines</u>. Among other changes, the proposed amendments would:
  - reduce the filing deadline for the initial Schedule 13D to five calendar days (from 10) after the date on which a person acquires more than 5% of a "covered class" of equity securities;
  - shorten the filing deadline for the initial Schedule 13D required to be filed by persons who forfeit their eligibility to report on Schedule 13G in lieu of Schedule 13D to five calendar days (from 10) after the event that causes the ineligibility;
  - shorten the deadline for the initial Schedule 13G filing for "Qualified Institutional Investors" and "Exempt Investors" to within five business days after the last day of the month in which beneficial ownership first exceeds 5% of a covered class (previously the deadline was 45 days after the calendar year-end);

Schedule 13D (cont.)

- require "Passive Investors" to file an initial Schedule 13G within five calendar days (from 10) after acquiring beneficial ownership of more than 5% of a covered class;
- revise the filing deadlines required for amendments to Schedule 13G in Rule 13d-2(b) to five business days after the end of the month in which a reportable change occurs (previously the deadline was 45 days after the calendar year-end); and
- amend Rule 13d-2(c) to shorten the filing deadline for Schedule 13G amendments filed by "Qualified Institutional Investors" and "Exempt Investors" to five calendar days after the respective filing threshold is met (from 10 calendar days after the end of the month in which the respective filing threshold is met).

Schedule 13D (cont.)

- Cash-Settled Derivatives. The proposing release would add new paragraph (e) to Rule 13d-3 to deem certain holders of cash-settled derivatives as beneficial owners of the covered class of equity securities. The application of proposed Rule 13d-3(e) would be limited to those persons who hold cash-settled derivatives with the purpose or effect of changing or influencing control of the issuer of the reference security. By contrast, security-based swaps would not be included among the derivative securities covered by proposed Rule 13d-3(e).
- Concerns have been raised by activist investors that new Rule 13d-3(e), when combined with the proposed reduction in the filing deadline for the initial Schedule 13D filing to five calendar days and the proposed changes set forth in the SEC's security-based swap release, will make it difficult in many circumstances for activist investors to accumulate a meaningful position in a company prior to public disclosure of the activist's position to the company and to other investors.
- Security-based swaps are addressed in separate rules proposed by the Commission in December 2021. *See* Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Exchange Act Release No. 93784 (Dec.15, 2021).

Schedule 13D (cont.)

- In addition, concerns have also been raised by practitioners about the unintended ramifications of new Rule 13d-3(e) and the changes to Rule 13d-5 discussed below under "Groups" on stock option plans, other compensation arrangements, financing arrangements and poison pills.
- Groups. The proposing release would amend Rule 13d-5 to (i) remove any potential implication that an express or implied agreement among group members is a necessary precondition to the formation of a group under Section 13(d)(3) or 13(g)(3) of the Exchange Act and (ii) affirm that if a person, in advance of filing a Schedule 13D, discloses to any other person that such filing will be made and such other person acquires securities in the covered class for which the Schedule 13D will be filed, then those persons are deemed to have formed a group within the meaning of Section 13(d)(3).
- Exemptions. New Rule 13d-6(c) would set forth the circumstances under which two or more persons may communicate and consult with one another and engage with an issuer without becoming subject to regulation as a group with respect to the equity securities of the issuer.

Schedule 13D (cont.)

- This rule would provide that two or more persons will not be deemed to beneficially own an issuer's equity securities as a group solely because of their concerted actions related to such issuer or its equity securities (including engagement with one another or the issuer or acquiring, holding, voting or disposing of the issuer's equity securities); provided that
  - (i) communications among such persons are not undertaken with the purpose or the effect of changing or influencing control of the issuer, and are not made in connection with or as a participant in any transaction having such purpose or effect, and
  - (ii) such persons, when taking such concerted actions, are not directly or indirectly obligated to take such actions, such as by a voting agreement or cooperation agreement.
- Many practitioners expect this exemption to be very useful for institutional investors in connection with the shareholder proposal process.

Schedule 13D (cont.)

- New Rule 13d-6(d) would set forth the circumstances under which two or more persons may enter into an agreement governing a derivative security in the ordinary course of business without becoming subject to regulation as a group with respect to the derivative's reference equity securities.
- This rule would provide that two or more persons will not be deemed to have formed a group under Section 13(d)(3) or 13(g)(3) solely by virtue of their entry into an agreement governing the terms of a derivative security, so long as:
  - (i) the agreement is a bona fide purchase and sale agreement entered into in the ordinary course of business, and
  - (ii) the parties to the agreement do not enter into the agreement with the purpose or effect of changing or influencing control of the issuer, or in connection with or as a participant in any transaction having such purpose or effect.
- <u>Section 16</u>. The proposed amendments to Rules 13d-3, 13d-5 and 13d-6 would directly impact the analysis under Rule 16a-1(a)(1) as to whether a person is a 10% holder. The proposing release does not propose any amendments to Rule 16a-1(a)(1).

Schedule 13D (cont.)

- Dissent. Commissioner Peirce issued a statement in dissent, stating that:
  - (i) the proposing release suggests that shortening the reporting window is appropriate given the technological advances since 1968 when Section 13(d) was enacted, but the current 10-day window does not appear to be based upon the limitations of 1960s technology,
  - (ii) the proposing release summarily concludes that the proposed amendments will achieve the proper balancing of interests between timely dissemination of information and preserving an incentive structure for investors to seek to change control at underperforming companies, without providing any evidence in support of this position,
  - (iii) there is no clear link provided in the proposing release between ownership of cash-settled derivatives and the potential to change control of the issuer, and
  - (iv) the expansion of the definition of beneficial ownership to include cash-settled derivatives lacks sufficient justification given that these securities do not convey ownership or voting rights.
- Commissioner Peirce also raised a concern that the proposed exemption for institutional investors engaged in concerted actions related to an issuer or its equity securities (as discussed above) may end up "swallowing the rule." *See* Dissenting Statement on Proposed Modernization of Beneficial Ownership Reporting, Statement of Commissioner Hester M. Peirce, Feb. 10, 2022.
- Activist Investors. The proposed amendments, if adopted, would have a significant impact on a variety of investors, including hedge funds that utilize an activist strategy where building a sizeable position prior to public disclosure is critical.

Rule 14a-8

- On September 23, 2020, the SEC voted to adopt amendments to modernize its shareholder proposal rule, which governs the process for a shareholder to have its proposal included in a company's proxy statement for consideration by all of the company's shareholders. *See* Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Exchange Act Release No. 34-89964 (September 23, 2020).
- The principal requirements for: (1) initial inclusion in the proxy statement (the amount and length of ownership of the proposing shareholder) and (2) for subsequent resubmission if the proposal is not approved (the amount of support from other shareholders) had not been substantively amended since 1998 and 1954, respectively.
- The amendments replaced the then-current ownership threshold, which required holding at least $2,000 or 1% of a company's securities for at least one year, with three alternative thresholds that will require a shareholder to demonstrate continuous ownership of at least:
  - $2,000 of the company's securities for at least three years;
  - $15,000 of the company's securities for at least two years; or
  - $25,000 of the company's securities for at least one year.
- The amendments also prohibited the aggregation of holdings for purposes of satisfying the amended ownership thresholds.

Rule 14a-8 (cont.)

- The amendments also raised the levels of shareholder support a proposal must receive to be eligible for resubmission at the same company's future shareholder meetings from 3%, 6% and 10% for matters previously voted on once, twice or three or more times in the last five years, respectively, with thresholds of 5%, 15% and 25%, respectively.
- These amendments went into effect for shareholder meetings held in 2022.
- In March 2021, Commissioner Allison Herren Lee, while serving as Acting Chair, asked the SEC staff to develop proposals for potentially revising Rule 14a-8 itself. *See* "A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC," Speech by then-Acting Chair Allison Herren Lee, March 15, 2021.

Rule 14a-8 (cont.)

- On November 5, 2021, the staff of the Division of Corporation Finance issued a Staff Legal Bulletin which explicitly rescinded three Staff Legal Bulletins issued in 2017, 2018 and 2019, respectively. *See* “Shareholder Proposals: Staff Legal Bulletin No. 14L (CF),” Staff Legal Bulletin, Division of Corporation Finance, November 3, 2021.
- <u>Policy Exception to Ordinary Business Operations</u>. Rule 14a-8(i)(7) permits a company to exclude a proposal that “deals with a matter relating to the company’s ordinary business operations.”
- In the 1998 adopting release, the Commission stated that the policy underlying the ordinary business exclusion rests on two central considerations; the first relates to the subject matter of the proposal and the second consideration relates to the degree to which the proposal seeks to “micro-manage” the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment.
- Under this exclusion, companies may exclude proposals relating to matters that are fundamental to management’s ability to run a company on a day-to-day basis unless, in the staff’s view, the proposal focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote.

Rule 14a-8 (cont.)

- The rescinded Bulletins established that the significance of an issue should be viewed in the context of the particular company, and encouraged companies to provide a board analysis assessing whether the particular policy issue raised by the proposal was sufficiently significant to the company.
- Under the new Bulletin, the staff will instead focus on whether the proposal raises issues with broad societal impact such that they transcend ordinary business. For example, the Bulletin provides that proposals raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the issue was significant to the company
- <u>Micromanagement</u>. Under the ordinary business exclusion, companies may exclude a proposal that "micromanages" the company, which may occur if the proposal "involves intricate detail, or seeks to impose specific time frames or methods for implementing complex policies."
- In one of the rescinded Bulletins, the staff expressed a view that its micromanagement determinations would turn on the prescriptiveness of a proposal.
- Under the new Bulletin, the staff will instead focus on "the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management."

Rule 14a-8 (cont.)

- In assessing whether a proposal delves into matters "too complex" for shareholder consideration, the staff may consider "the sophistication of investors generally on the matter, the availability of data, and the robustness of public discussion and analysis on the topic," and also references "well-established national or international frameworks when assessing proposals related to disclosure, target setting, and time frames."
- The new Bulletin notes that the staff will not concur with exclusion of climate change proposals that "suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."
- <u>Relevance</u>. Rule 14a-8(i)(5) permits a company to exclude a proposal that relates to operations which account for (i) less than 5% of the company's total assets at the end of its most recent fiscal year, and (ii) for less than 5% of its net earnings and gross sales for its most recent fiscal year, provided that such proposal is not otherwise significantly related to the company's business.
- One of the rescinded Bulletins encouraged companies to submit a board analysis to support the argument that the proposal topic was not significantly related to the company's business. The new guidance rejects the need for a board analysis and reverts to the prior approach of not excluding proposals that "raise issues of broad social or ethical concern related to the company's business" even if the relevant business falls below the economic thresholds of Rule 14a-8(i)(5).

Rule 14a-8 (cont.)

- On July 13, 2022, the Commission voted 3-2 to issue proposed rules (the "Proposed 14a-8 Amendments") updating certain bases for exclusion of shareholder proposals under Rule 14a-8. *See* Substantial Implementation, Duplication, and Resubmission of Shareholder Proposals under Exchange Act Rule 14a-8, Exchange Act Release No. 93267 (July 13, 2022).
- Rule 14a-8 requires companies that are subject to the federal proxy rules to include shareholder proposals in their proxy statements to shareholders, subject to certain procedural and substantive requirements. Under Rule 14a-8, a company must include a shareholder's proposal in the company's proxy materials unless the proposal fails to satisfy any of several specified substantive requirements or the proposal or shareholder-proponent does not satisfy certain eligibility or procedural requirements.
- If a company intends to exclude a shareholder proposal from its proxy materials, it is required under Rule 14a-8(j)(1) to "file its reasons" for doing so with the Commission. These notifications are generally submitted in the form of no-action requests, with companies seeking the staff's concurrence that they may exclude a shareholder proposal under one or more of the procedural or substantive bases under Rule 14a-8.
- The Commission is proposing modification to three of the rule's substantive bases for exclusion: Rule 14a-8(i)(10) (substantial implementation), Rule 14a-8(i)(11) (duplication) and Rule 14a-8(i)(12) (resubmissions); the bases for exclusion in those rules collectively represent a significant percentage of the no-action requests the staff receives under Rule 14a-8.

Rule 14a-8 (cont.)

- <u>Substantial Implementation</u>. First, the Commission proposes to amend the substantial implementation exclusion, which allows companies to exclude a shareholder proposal that “the company has already substantially implemented,” which standard has remained substantively unchanged since 1983.
- During the 2021 proxy season, the staff received 110 no-action requests asserting the substantial implementation threshold, and the staff concurred with 36 of the requests.
- As proposed to be amended, a company could only exclude a proposal under this exclusion if the company has already implemented the “essential elements” of the proposal.
- <u>Duplication</u>. Second, the Commission proposes to amend the duplication exclusion, which allows companies to exclude a shareholder proposal if it substantially duplicates another shareholder proposal previously submitted to the company by another shareholder that will be included in the company’s proxy statement for the same meeting.
- This exclusion was adopted in 1976 and has remained substantively unchanged since adoption. During the 2021 proxy season, the staff received 12 no-action requests asserting the duplication exclusion, and concurred in three of the requests.
- As proposed to be amended, a company could only exclude a proposal under this exclusion if the other proposal addresses the same subject matter and seeks the same objectives by the same means.

Rule 14a-8 (cont.)

- In the proposing release the Commission noted that it was aware of the possibility that the proposed amendment could result in the inclusion in a company's proxy materials of multiple shareholder proposals dealing with the same or similar issue, which could cause shareholder confusion and may lead to conflicting or inconsistent results and implementation challenges for companies if shareholders approve multiple similar, although not duplicative, proposals.
- Thus, the proposing release seeks comment on the possible implications for companies and shareholders of the amendments to the duplication exclusion.
- <u>Resubmission</u>. Third, the Commission proposes to amend the resubmission exclusion, which currently provides that a shareholder proposal may be excluded from a company's proxy statement if:
  - (i) the proposal addresses substantially the same subject matter as a proposal previously included in the company's proxy materials within the preceding five calendar years, (ii) the matter was voted on at least once in the last three years and (iii) the matter did not receive the minimum required votes discussed above.
- During the 2021 proxy season, the staff received two no-action requests asserting the resubmission exclusion, and the staff concurred in one of the requests.

Rule 14a-8 (cont.)

- Since 1948, the Commission has not required a company to include a shareholder proposal in its proxy statement if "substantially the same proposal" previously had been submitted for a shareholder vote and did not receive a specified minimum percentage of votes upon its most recent submission. For many years following adoption of the provision, the staff interpreted the phrase "substantially the same proposal" to mean one that is virtually identical (in form as well as substance) to a proposal previously included in the issuer's proxy statement.
- In response to commentators who had asserted that the provision failed to accomplish its stated purpose because a proponent was able to evade exclusion of its proposal by simply changing the language of the proposal in a manner that precluded one from saying that the proposal is virtually identical to a prior proposal, in 1983 the Commission revised the resubmission exclusion to permit the exclusion of proposals dealing with "substantially the same subject matter" as proposals submitted in prior years that received support below specified vote thresholds.
- This "substantially the same subject matter" test has been in place since 1983, though the Commission has revisited the minimum vote thresholds necessary for resubmission under the provision from time to time and as discussed above increased the resubmission thresholds in 2020.

Rule 14a-8 (cont.)

- In the proposing release, the Commission states that it shares the concerns of some commentators during the 2020 amendment process who felt that the “substantially the same subject matter” standard in place since 1983 unduly constrains shareholder suffrage.
- Thus, the Commission is proposing to amend the standard of what constitutes a resubmission under Rule 14a-8(i)(12) from a proposal that “addresses substantially the same subject matter” as a prior proposal to a proposal that “substantially duplicates” a prior proposal, which is the same standard that applies under the current duplication exclusion.
- A proposal “substantially duplicates” another proposal if it “addresses the same subject matter and seeks the same objective by the same means.

Rule 14a-8 (cont.)

- Ordinary Business. In addition, the proposing release also reaffirms the standards the Commission articulated in 1998 for determining whether a proposal relates to ordinary business for purposes of Rule 14a-8(i)(7), and as further discussed in a recent Staff Legal Bulletin discussed above.
- As to the subject matter of the proposal, a proposal that the staff previously viewed as excludable because it did not raise a significant policy issue for the company would no longer be subject to exclusion if it raised an issue with a broad societal impact. As to micromanagement, the Bulletin made clear that a proposal suggesting targets or timelines (such as those dealing with greenhouse gas emissions) would not be excludable as "micromanagement" so long as the proposal afforded discretion to management as to how to achieve the goals
- Comment Period. Comments on the Proposed 14a-8 Amendments must be received by the later of September 12, 2022 or 30 days after the proposing release is published in the Federal Register.

Rule 14a-8 (cont.)

- Dissent. Commissioner Peirce issued a statement in dissent, noting that Rule 14a-8 was amended less than two years ago and companies have yet to experience a full proxy season with the changes in effect, and stating that a better approach would have been to allow sufficient time to see how the September 2020 amendments operate and whether further changes are appropriate.
- As to the proposed amendments to the specific bases for exclusion, (i) for the substantial implementation exclusion, she noted that what constitutes an "essential element" is not clear and that the staff will defer to the assessment of the shareholder as to what is essential; (ii) for the duplication exclusion, she noted that given it will no longer provide a basis for exclusion unless the proposals are seeking exactly the same thing, the likely result is multiple overlapping or conflicting proposals on the same topic on the same proxy; and (iii) for the resubmissions exclusion, she noted that this basis will not exclude any proposal unless it is nearly identical to a prior proposal, and that shareholders will use this new language to get around the resubmission limits just as their pre-1983 counterparts did with the "substantially the same proposal" standard in effect at that time. *See* Exclusion Preclusion: Statement on the Shareholder Proposals Proposal, Commissioner Hester M. Peirce (July 13, 2022).
- Takeways. If enacted, the Proposed 14a-8 Amendments will practically repeal the September 2020 amendments to Rule 14a-8.

Climate Disclosure Rules

- On March 22, 2022, the SEC voted 3-1 to propose rules requiring registrants to provide additional climate-related information in their registration statements and annual reports, including in their financial statements. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (Mar. 22, 2022).
- The proposed amendments are modeled in large part on the recommendations of the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol, which protocol is an accounting and reporting standard for greenhouse gas ("GHG") emissions created through a partnership between the World Resources Institute and the World Business Center for Sustainable Development.
- The proposing release provides that the proposed amendments set forth therein would supplement (rather than replace) the disclosures already required in SEC filings and that registrants should thus continue to assess whether disclosure of climate risks is still required in MD&A, Description of Business, Risk Factors or Legal Proceedings as per exiting guidance.
- The proposing release sets forth proposed rules dealing with (i) Climate-Related Disclosure, (ii) Climate-Related Impacts, (iii) Governance, (iv) Risk Management, (v) Financial Statement Metrics, (vi) GHG Emissions, (vii) Attestation of Scope 1 and Scope 2 Emissions Disclosures, and (viii) Targets and Goals.

Climate Disclosures Rules (cont.)

- Climate-Related Disclosure. The proposed climate-related disclosures described below would apply to a registrant with Exchange Act reporting obligations pursuant to Section 13(a) or Section 15(d) and companies filing a Securities Act or Exchange Act registration statement. Thus, the climate-related disclosures and the proposed financial statement metrics would be required in Securities Act or Exchange Act registration statements and Exchange Act annual reports. The proposed rules would also require registrants to disclose any material change to the climate-related disclosure provided in a registration statement or annual report in its Form 10-Q.
- The climate-related disclosures would be required to be included in such statements and reports in a separately captioned “Climate-Related Disclosure” section and in the financial statements.
- The proposed rules would require a registrant to disclose any climate-related risks reasonably likely to have a material impact on the registrant, which may arise over the short, medium and long term.
- “Climate-related risks” mean the actual or potential negative impacts of climate-related conditions and events on a registrant’s operations, financial statements or value chains, as a whole.

Climate Disclosure Rules (cont.)

- "Value chain" means the upstream and downstream activities related to a registrant's operations, with "upstream activities" defined to include activities by a third party that relate to the initial stages of production and "downstream activities" defined to include activities by a third party that relate to processing material into a finished product and delivery of a good or service to the end user.
- The proposed rules would require a registrant to specify whether an identified climate-related risk is a physical or transition risk and the registrant's plan to mitigate the risk.
- If an identified physical risk is likely to have a material impact on the registrant's business or financial statements, the registrant would be required to include in its description the location (by zip code or, if not available, by postal zone or geographic location) of the properties, processes, or operations subject to the physical risk.
- The proposed rules would also require a registrant to describe the nature of transition risks, including whether they relate to regulatory, market, technological, or other transition-related factors, and how those factors impact the registrant.
- A registrant is also permitted but not required to disclose information about any "climate-related opportunities" it may be pursuing.

Climate Disclosure Rules (cont.)

- Climate-Related Impacts. Once a registrant has described the climate-related risks reasonably likely to have a material impact on the registrant's business or financial statements as manifested over the short, medium, and long term, the proposed rules would require the registrant to describe the actual and potential impacts (and the time horizon for each) of those risks on its strategy, business model, and outlook.
- The proposed rules would require a registrant to discuss how it has considered the impacts as part of its business strategy and capital allocation.
- The proposed rules would require a registrant to provide a narrative discussion of whether and how any of its identified climate-related risks have affected or are reasonably likely to affect the registrant's consolidated financial statements.
- If, as part of its net emissions reduction strategy, a registrant uses carbon offsets or renewable energy credits ("RECs"), the proposed rules would require it to disclose the role that carbon offsets or RECs play in the registrant's climate-related business strategy.
- Registrants may choose to use an internal carbon price when quantifying and assessing the financial impacts of climate-related risks and climate-related opportunities.
- A registrant would be required to describe any analytical tools, such as scenario analysis, that the registrant uses to (i) assess the impact of climate-related risks on its business and financial statements, or (ii) support the resilience of its strategy and business model in light of foreseeable climate-related risks.

Climate Disclosure Rules (cont.)

- <u>Governance</u>. The proposed rules would require disclosure of:
  - (i) any board members or board committees responsible for the oversight of climate-related risks,
  - (ii) whether any board member has expertise in climate-related risks,
  - (iii) the processes and frequency by which the board discusses these risks,
  - (iv) how the board considers these risks as part of its business strategy, risk management and financial oversight, and
  - (v) how the board sets climate-related targets or goals and oversees progress against those targets or goals.
- The proposed rules would require disclosure of:
  - (i) the management positions or committees responsible for assessing and managing climate-related risks,
  - (ii) the relevant expertise of the position holders or committee members, and
  - (iii) the processes by which these position holders or committee members are informed about and monitor climate-related risks, and how frequently they report to the board about these risks.

Climate Disclosure Rules (cont.)

- Risk Management. The proposed rules would require disclosure of any processes a registrant has for identifying, assessing, and managing climate-related risks.
- A registrant would be required to disclose:
  - (i) how it decides whether to mitigate, accept, or adapt to any such climate-related risk,
  - (ii) how it prioritizes addressing climate-related risks, and
  - (iii) how it mitigates a high priority climate-related risk.
- The proposed rules would also require a registrant to disclose whether and how climate-related risks are integrated into the registrant's overall risk management processes.
- If a registrant has adopted a transition plan as part of its climate-related risk management strategy, the proposed rules would require the registrant to describe its plan, including the metrics used to manage physical and transition risks.
- In addition, the registrant would be required to describe (i) how it plans to mitigate or adapt to any physical risks identified in its SEC filings, and (ii) how it plans to mitigate or adapt to any identified transition risks.
- Further, the registrant would also be required to update its transition plan disclosure each year by describing the actions taken during the past year to achieve the plan's goals.

Climate Disclosure Rules (cont.)

- Financial Statement Metrics. A registrant that is required pursuant to Regulation S-K to include a Climate-Related Disclosure section in a form that also includes audited financial statements, would be required to disclose in a note to these financial statements certain disaggregated climate-related financial statement metrics that are generally derived from existing financial statement line items.
- In particular, the proposed rules would require disclosure of “financial impact metrics,” “expenditure metrics,” and “financial estimates and assumptions.” For each metric, the proposed rules would require a registrant to disclose contextual information to enable a reader to understand how it derived the metric (including a description of significant inputs and assumptions used and any policy decisions made to calculate the metric).
- A registrant would be required to calculate the metrics using financial information that is consistent with the scope of the rest of the registrant’s consolidated financial statements included in the filing.
- Therefore, a registrant would have to include in any such calculation information from consolidated subsidiaries and would have to apply the same set of accounting principles that it is required to apply in preparation of the remainder of the financial statements included in the filing.

Climate Disclosure Rules (cont.)

- Disclosure would be required to be provided for the registrant’s most recently completed fiscal year and for the historical fiscal years included in the financial statements in the filing, subject to exceptions for historical periods for information not known or reasonably available to the registrant.
- As to “financial impact metrics,” the SEC is also proposing to amend Regulation S-X to require a registrant to include disaggregated information about the impact of climate-related conditions and events, and transition activities, on the consolidated financial statements included in the applicable filing. The proposed rules would require a registrant to disclose the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the financial statements included in the relevant filing unless the aggregated impact of severe weather events, other natural conditions, transition activities, and identified climate-related risks is less than one percent of the total line item for the relevant fiscal year.
- A registrant would be required to determine the impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on each financial statement line item.

Climate Disclosure Rules (cont.)

- As to "expenditure metrics," the metrics refer to the positive and negative impacts associated with the same climate-related events, transition activities, and identified climate-related risks as the proposed financial impact metrics discussed above.
- The proposed "expenditure metrics" rules would require a registrant to separately aggregate amounts of (i) expenditure expensed and (ii) capitalized costs incurred during the fiscal years presented.
- The proposed expenditure metrics would be subject to the same disclosure threshold as the financial impact metrics.
- As to "financial estimates and assumptions," the proposed rules would require a registrant to disclose whether the estimates and assumptions used to produce the financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events. If so, the registrant would be required to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used by the registrant in the preparation of the financial statements.
- The proposed financial statement metrics would be required in the financial statements. Therefore, such metrics would be (i) included in the scope of any required audit of the financial statements, (ii) subject to audit by an independent registered public accounting firm, and (iii) within the scope of the registrant's ICFR.

Climate Disclosure Rules (cont.)

- GHG Emissions. The proposed rules would require a registrant to disclose its GHG emissions for its most recently completed fiscal year, which rules are based on the concepts of scopes. Scopes are based on the concepts of direct and indirect emissions. The proposed definitions of Scope 1, Scope 2 and Scope 3 are substantially similar to the definitions provided by the GHG Protocol.
- The Proposing Release defines:
  - (i) Scope 1 emissions as direct GHG emissions from operations that are owned or controlled by the registrant;
  - (ii) Scope 2 emissions as indirect GHG emissions from the generation of purchased electricity, steam, heat, or cooling that is consumed by operations owned or controlled by the registrant; and
  - (iii) Scope 3 emissions as all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain.
- The proposed rules would require a registrant to disclose its total Scope 1 emissions and its total Scope 2 emissions (regardless of materiality) after calculating them from all sources that are included in the registrant's organizational and operational boundaries (as described below). A registrant would also be required to disclose separately its total Scope 3 emissions for the fiscal year if those emissions are material, or if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.

Climate Disclosure Rules (cont.)

- When assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions.
- However, even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions, a quantitative analysis alone would not be sufficient for purposes of determining whether Scope 3 emissions are material and a registrant would also need to consider qualitative factors.
- Accordingly, Scope 3 emissions may make up a relatively small portion of a registrant's GHG emissions but still be material where Scope 3 represents "a significant risk," Scope 3 is "subject to significant regulatory focus," or if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision.
- For each scope of emissions, the proposed rules would require a registrant to disclose (i) the emissions disaggregated by each constituent GHG and (ii) GHG emissions data in the aggregate, excluding any offsets.
- The proposed rules would require a registrant to express each scope of its GHG emissions in terms of carbon dioxide equivalent ("CO2e"), which is the unit of measurement used by the GHG Protocol to indicate the global warming potential of each GHG.

Climate Disclosure Rules (cont.)

- If required to disclose Scope 3 emissions, a registrant would need to identify the categories of upstream and downstream activities that have been included in the calculation of its Scope 3 emissions and describe the data sources used to calculate these emissions.
- If any upstream or downstream activities were significant to the registrant when it calculated its Scope 3 emissions, the proposed rules would require the registrant to identify such categories and separately disclose Scope 3 emissions data for each of those categories, together with a total of all Scope 3 emissions.
- The proposed rules would also require a registrant to disclose the sum of its Scopes 1 and 2 emissions as to GHG intensity. Also, if required to disclose Scope 3 emissions, a registrant would be required to separately disclose its Scope 3 emissions as to GHG intensity. The proposed rules would define “GHG intensity” to mean a ratio that expresses the metric tons of CO2e per unit of total revenues or per unit of production.
- The proposed rules would require disclosure to be provided for the registrant’s most recently completed fiscal year and for the historical fiscal years included in the registrant’s financial statements in the applicable filing, to the extent such historical GHG emissions data is reasonably available, with exceptions for smaller reporting companies.

Climate Disclosure Rules (cont.)

- As proposed, a registrant would be required to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics. The description of the registrant's methodology would be required to include the registrant's organizational boundaries, operational boundaries, calculation approach, and any calculation tools used to calculate the registrant's GHG emissions.
- "Organizational boundaries" would mean the boundaries that determine the operations owned or controlled by a registrant for the purpose of calculating its GHG emissions.
- "Operational boundaries" would mean the boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant.
- A registrant also needs to select a GHG emissions calculation approach. The proposing release provides that an acceptable method for calculating emissions involves the application of published emission factors. Emission factors are ratios that typically relate GHG emissions to a proxy measure of activity at an emissions source.

Climate Disclosure Rules (cont.)

- The Proposing Release sets forth certain accommodations for Scope 3 emissions disclosure, including (i) a safe harbor for Scope 3 emissions disclosure from certain forms of liability under the Federal securities laws, (ii) an exemption for smaller reporting companies from the Scope 3 emissions disclosure requirements, and (iii) a delayed compliance date for Scope 3 emissions disclosure.
- <u>Attestation of Scope 1 and Scope 2 Emissions Disclosure</u>. The proposed rules would require a registrant that is an accelerated filer or large accelerated filer to include in the relevant filing an attestation report covering the disclosure of its Scope 1 and Scope 2 emissions.
- The attestation engagement must, at a minimum, be at the "limited assurance" level as to the required GHG emissions disclosure for fiscal years two and three after the disclosure compliance date and at the "reasonable assurance" level for fiscal years four and beyond.
- The proposed rules also set forth minimum qualifications and independence requirements for the attestation service providers. The attestation provider would be subject to liability under the federal securities laws for the attestation conclusion.
- The proposed rules also set forth certain requirements for the attestation report, which report is to be included in the separately captioned "Climate-Related Disclosure" section in the relevant filing.

Climate Disclosure Rules (cont.)

- Targets and Goals. If a registrant has set any climate-related targets or goals, then the proposed rules would require the registrant to provide certain information about those targets or goals, including a description of (if applicable):
  - (i) the scope of activities and emissions included in the target;
  - (ii) the unit of measurement;
  - (iii) the time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;
  - (iv) the defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
  - (v) any interim targets; and
  - (vi) how the registrant intends to meet its climate-related targets or goals.
- If a registrant has used carbon offsets or RECs in its plan to achieve climate-related targets or goals, it would be required to make certain disclosures relating thereto.

Climate Disclosure Rules (cont.)

- Commissioner Hester Peirce issued a long statement in dissent. Her main arguments are that (i) public companies are already required to disclose material client risks by existing SEC rules; (ii) the proposed materiality analysis for Scope 3 disclosures departs from the “reasonable investor” standard set forth by the Supreme Court; (iii) the justification for the SEC’s disclosure mandate provided in the proposing release departs from the SEC’s traditional company-specific approach to disclosure and suggests it is appropriate for shareholders of the disclosing company to subsidize other investors’ portfolio analysis; (iv) the proposal exceeds the SEC’s statutory limits by using the disclosure rules to achieve objectives that are outside of the SEC’s statutory mission (protecting investors, facilitating capital formation and fostering fair, orderly and efficient markets) and by pursuing those objectives by disclosure mandates that may violate First Amendment limitations on compelled speech; (v) the economic analysis underestimates the cost of the proposal, including the costs of the Scope 3 disclosure framework, compliance with the attestation requirements, and audit costs; (vi) the proposal will not lead to comparable, consistent and reliable disclosure because the underlying data is unlikely to be reliable; and (vii) the proposal will hurt investors, the economy and the SEC by pushing capital allocation toward politically and socially favored ends, especially when the SEC has no expertise in capital allocation or the applicable science.
- *See* We are Not the Securities and Environmental Commission – At Least Not Yet, Commissioner Hester M. Peirce (Mar. 21, 2022).

Climate Disclosure Rules (cont.)

- On June 30, 2022, the U.S. Supreme Court issued its decision in West Virginia et al. v. Environmental Protection Agency et al., slip opinion (June 30, 2022).
- In this matter, the U.S. Supreme Court's used the "major questions" doctrine to strike down the EPA's Clean Power Plan, holding that if a federal agency wants to adopt an "extraordinary" regulation like the one at issue in this matter, it must show that Congress clearly authorized it to do so.
- Legal commentators have noted that this decision could have ramifications for other agency rulemaking, including the SEC's proposed climate disclosure rules.

Climate Disclosure Rules (cont.)

- In October 2023 California Governor Newsom signed into law state Senate Bill 253 ("SB 253") and state Senate Bill 261 ("SB 261"), ushering in significant climate-related disclosure requirements for thousands of U.S. companies that do business in California.
- SB 253 requires companies with greater than $1 billion in annual revenues to file annual reports publicly disclosing their direct, indirect, and supply chain GHG emissions, verified by an independent and experienced third-party provider.
- SB 261 requires companies with $500 million in annual revenues to prepare biennial reports disclosing climate-related financial risk and measures they have adopted to reduce and adapt to that risk, with the first report due by January 1, 2026.
- The bills apply to both public and private companies.
- Scope 3 disclosure is required regardless of materiality.

Security-Based Swaps

- On December 15, 2021, the SEC voted 3-2 to propose three rules under the Exchange Act concerning security-based swaps. Swaps are financial contracts in which two counterparties agree to exchange or “swap” payments with each other as a result of such things as changes in a stock price, interest rate, or commodity price. *See* Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Exchange Act Release No. 34-93784 (December 15, 2021); Prohibition Against Fraud, Manipulation, and Deception in Connection with Security Based Swaps, Exchange Act Release No. 34-63236 (December 15, 2021); Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statements Applicable to Security-Based Swaps Proposed Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 34-69491 (December 15, 2021).
- The proposed rules are aimed at fulfilling the SEC’s mandate to regulate security-based swaps in Title VII of the 2010 Dodd-Frank Act.

Security-Based Swaps (cont.)

- Proposed Exchange Act Rule 10B-1. This proposed rule would require any person, or group of persons, who owns a security-based swap position that, together with holdings of the referenced instrument and other specified instruments providing exposure to the referenced instrument, exceeds one of several specified threshold amounts set by the rule, to promptly file on EDGAR a statement containing certain information as to these holdings.
- Under the proposed rule, security-based swap counterparties who trigger the reporting requirements would be required to disclose, among other information:
  - the applicable security-based swap position (including the direction, *i.e.*, long or short);
  - positions in any security or loan underlying the security-based swap position;
  - other security-based swaps on other securities of the same referenced issuer;
  - positions in other instruments relating to the security-based swap position or the referenced security or loan or group or index of securities or loans; and
  - specified identifying information regarding the reporting person.
- Reportable security-based swaps are limited to security-based swaps: (i) subject to transaction reporting under Rule 908 of Regulation SBSR; or (ii) entered into by a person that also holds an interest in the securities underlying the security-based swap (or is deemed to be the beneficial owner of such securities) if (1) the issuer of referenced securities is established as an entity in the U.S. and has its principal place of business in the U.S. or (2) the referenced security is part of a class of securities registered under Section 12 or Section 15(d) of the Exchange Act.

Security-Based Swaps (cont.)

- The proposed rule would apply to both cleared and uncleared security-based swaps.
- As a result of the definition of "swap" under the Commodity Exchange Act, security-based swaps generally should not be deemed to include an option on securities.
- The threshold amounts would vary based on the type of swap and are calculated by reference to holdings of the reporting person in addition to the security-based swap, which other positions are specified and differ depending upon the type of security-based swap held by the reporting person.
- For security-based swaps that are credit default swaps ("CDS"), the threshold for a long CDS position is generally the lesser of: (i) a long notional amount of $150 million; (ii) a short notional amount of $150 million; or (iii) a gross notional amount of $300 million.
- For security-based swap positions based on debt securities that are not CDS, the threshold is a gross notional amount of $300 million.
- For security-based swap positions based on equity securities, the threshold is generally the lesser of: (i) a gross notional amount of $300 million; or (ii) a security-based swap equivalent position that represents more than 5% of a class of equity securities.
- A security-based swap position exceeding the threshold amount would be required to be reported on Schedule 10B, together with holdings in the referenced instrument and related instruments, no later than the end of the first business day following the execution of the security-based swap.

Security-Based Swaps (cont.)

- Under the proposed rule, a person who has previously filed a Schedule 10B must file an amendment to the Schedule promptly if any material change occurs in the facts set forth in the previous filing, including, without limitation, any material increase or decrease in the security-based swap position or a decline in the security-based swap position below the applicable threshold amount. For these purposes, a "material" change in the position would be an acquisition or disposition equal to 10% or more of the previously disclosed, security-based swap position.
- A person reporting on Schedule 10B would not be required to file the actual contracts governing the security-based swaps, although it must provide a "brief description" of the contracts or relationships regarding the security-based swaps included in the security-based swap position and other instruments disclosed on the Schedule.
- The SEC does not believe that the large trader position reporting requirements of Rule 10B-1 are duplicative of Regulation SBSR transaction reporting requirements, which governs regulatory reporting of security-based swap transactions to security-based swap data repositories ("SBSDRs") and public dissemination of some of that data.
- The Proposing Release highlights that Regulation SBSR requires real-time public reporting to SBSDRs and public dissemination of security-based swap transaction data, but not position data as contemplated by the proposed rule. In addition, Regulation SBSR only requires reporting of security-based swaps, while the proposed rule would require reporting of positions in both security-based swaps and related securities.

Security-Based Swaps (cont.)

- The collapse of several major institutions, particularly investment firm Archegos Capital Management ("Archegos"), appears to have motivated the proposal of this rule. On March 26, 2021, Archegos defaulted on a number of security-based swaps, causing several large banks to incur over $10 billion in losses. Archegos held large long positions in security-based swaps structured as total return swaps on equity.
- The SEC noted that the lack of public information about Archegos' total market position meant that security-based swap counterparties and other market participants were not aware of Archegos' risk of default. The SEC also noted that the leverage embedded in the security-based swaps held by Archegos accelerated the losses experienced by Archegos and ultimately led to large losses by security-based swap counterparties and prime brokers.
- The SEC expressed the view that reporting should alleviate the information asymmetry that results from a party attaining exposure to securities' position through security-based swaps rather than through investment in the referenced securities themselves.
- In addition, the SEC noted that position reporting should alert market participants and regulators to the existence of concentrated exposures held by counterparties.

Security-Based Swaps (cont.)

- The approach taken by the SEC in proposed Rule 10B-1 to address the perceived information asymmetries relating to security-based swaps does not seek to change existing guidance regarding the definition of beneficial ownership of securities, as applied under Sections 13(d) and 16 of the Exchange Act and the rules thereunder. Under the current rules, most security-based swap agreements do not confer beneficial ownership over their reference securities on the party that is "long", absent an intent to evade the reporting requirements of Sections 13(d) and (g) of the Exchange Act.
- Security-based swap agreements generally provide that the swaps are to be settled only in cash, do not confer voting or investment rights with respect to the reference securities, and do not require that the "short" counterparty hedge its position by holding the reference securities.
- The Dodd-Frank Act granted authority to the SEC to determine when security-based swaps confer beneficial ownership and directed the SEC to address a court decision, *CSX Corporation v. The Children's Investment Fund Management (UK) LLP*, which had suggested that cash-settled, security-based swaps could confer beneficial ownership to the long counterparty.
- The SEC clarified in 2011 that, following the enactment of Section 13(o), the beneficial ownership rules in effect at that time continued to apply to security-based swaps to the same extent as prior to such enactment.
- New proposed Rule 10B-1 preserves the approach taken by the SEC in 2011 and addresses reporting without changing the status quo with respect to beneficial ownership of hedges or securities referenced by security-based swaps.

Security-Based Swaps (cont.)

- Proposed Rule 9j-1. This proposed rule would prohibit fraudulent, deceptive, or manipulative conduct in connection with transactions in security-based swaps, including misconduct in connection with the exercise of any right or performance of any obligation under a security-based swap. Rule 9j-1 follows the approach proposed in 2010, but is expanded in various aspects.
- The SEC noted that the provisions combine the anti-fraud and anti-manipulation provisions of Section 10(b) of the Exchange Act, Rule 10b-5 under the Exchange Act, and Section 17(a) of the Securities Act and apply them to security-based swaps.
- Rule 9j-1(a) would also prohibit an “attempt” to disseminate false financial information or data in connection with the sale of a security-based swap or insider trading in a security-based swap.
- In proposing the anti-fraud and anti-manipulation rules applicable to security-based swaps, the SEC acknowledged that the existing antifraud and anti-manipulation provisions of the federal securities laws already apply to security-based swaps because they fall within the definition of “security” in each of those statutes. The SEC noted, however, that the scope of those provisions were directed at actions in connection with the “purchase” or “sale” of security-based swaps and that the scope of the proposed rules would encompass a broader scope and timeline, including, without limitation, early termination of transactions and posting of collateral.
- Rule 9j-1(b) would prohibit price manipulation and attempted price manipulation, similar to CFTC Rule 180.2.

Security-Based Swaps (cont.)

- The SEC indicated in the Proposing Release that it had been motivated to propose Rule 9j-1(b), in part, by market developments in recent years concerning manufactured credit events or other opportunistic strategies in the CDS market, including situations where a party intentionally distorts any payment related to a security-based swap for the benefit of a counterparty.
- Rule 9j-1 would also impose liability for trading while in possession of MNPI. Subsections (c) and (d) of Rule 9j-1 would impose liability on market participants for effecting a fraudulent scheme through the purchase or sale of a referenced security, rather than the purchase or sale of the security-based swap on which it is based, and vice versa, while in possession of MNPI.
- <u>Proposed Rule 15Fh-4(c)</u>. This proposed rule would prohibit personnel of a security-based swap dealer or major security-based swap participant from taking actions to coerce, mislead, or otherwise interfere with such entity's chief compliance officer.

Security-Based Swaps (cont.)

- Commissioners Hester M. Peirce and Elad L. Roisman dissented. Commissioner Peirce stated that the reporting rules “may serve to squelch legitimate market activity” and would appear to be “premature” given that security-based swap transaction reporting commenced only one month earlier. She also expressed concern that prohibiting attempted (in addition to actual) fraudulent behavior could create uncertainty for market participants who may be concerned about how the SEC or counterparties will “assess even innocuous conduct in retrospect,” and that “manufactured credit events” and other opportunistic strategies involving security-based swaps may not be serious enough to warrant regulation. *See* “Dissenting Statement on Proposed Security-Based Swap Rules,” Statement of Commissioner Hester M. Peirce, December 15, 2021.
- Transaction reporting for security-based swaps has been required since November 8, 2021, and public dissemination began on February 14, 2022.
- Commissioner Roisman stated that it was not clear that the large amount of information to be reported under Proposed Rule 10B-1 would be effective for achieving the goals stated for the proposed rule. *See* “Dissenting Statement on Proposed Security-Based Swaps Rules,” Statement of Commissioner Elad L. Roisman, December 15, 2021.

PRESENTER PROFILE

ROBERT B. STEBBINS
Partner
Corporate & Financial Services
Corporate Governance

T 212 728 8736
F 212 728 9736

EDUCATION
Central Michigan University
BS, 1988
University of Pennsylvania Law School
JD, 1993

Robert B. Stebbins is a partner in the Corporate & Financial Services Department, and co-head of the Firm's Corporate Governance practice. Bob has a diverse practice, focusing on SEC compliance and enforcement issues, corporate governance matters, internal and governmental investigations, and advising boards of directors. He also has 25 years of experience as a transactional attorney, focusing on mergers and acquisitions, private equity and venture capital matters, investment funds, and capital markets transactions.

Bob practiced law at Willkie from 1993 to 2017, first as an associate and beginning in 2001 as a partner. From May 2017 to January 2021, Bob served as General Counsel for the Securities and Exchange Commission in Washington, DC. As the SEC's chief legal officer and head of its Office of the General Counsel (OGC), Bob led a 150-person team responsible for litigation, advising on rulemaking matters and enforcement actions, and preparing Commission opinions in adjudications. He led OGC during one of the most active and wide-ranging rule calendars in the agency's history, advising on more than 85 rules, and hundreds of SEC and staff orders and interpretive releases. During his tenure, OGC also provided day-to-day guidance to the SEC's Enforcement Division on over 2,750 enforcement actions.

In his capacity as General Counsel, Bob structured and supervised internal investigations, coordinated interagency matters with other federal agencies, provided briefings to Congressional committees and was actively involved in the restarting of the SEC's Fellowship Program with a focus on hiring minority attorneys. In the 2020 Federal Employee Viewpoint Survey, OGC ranked as the seventh-best place to work out of 411 federal government offices (2019, 14th out of 420; 2018, 5th out of 415).

During the spring of 2020, he was detailed to the Department of the Treasury to advise on the CARES Act implementation (while at the same time continuing to function as the SEC's General Counsel), for which service he received the Secretary of Treasury's Honor Award.

Bob is a member of the American Bar Association and its M&A Committee, a member of the New York City Bar Association and its Securities Regulation Committee, and a member of the Society for Corporate Governance. He serves on the Board of Advisors of the Institute for Corporate Governance & Finance at New York University School of Law and is a frequent speaker at law schools, conferences and continuing education seminars.