Barley Snyder

Securities Changes for 2021

PUBLISHED ON
January 22, 2021

The 2021 proxy and annual reporting season will soon be underway, and the new year brings key changes to disclosure requirements and considerations for many public companies. This client alert provides an overview of key issues public companies should consider as they prepare for the upcoming proxy and annual reporting season, and beyond. We also reference some important developments for private offerings. The year 2020, although not "active" for many purposes, was particularly active in the securities context.

This client alert will discuss:

- The impact of COVID-19 on proxy statement disclosures;
- Other proxy statement considerations;
- A variety of changes and updates in reporting and disclosure obligations, including updated SEC guidance on COVID-19 and MD&A and amendments to Regulation S-K;
- Replacement of Industry Guide 3 (relating to statistical disclosures by bank holding companies) with Subpart 1400 of Regulation S-K;
- NASDAQ's proposed diversity rules;
- Amended rules impacting exempt offerings and expanding the definition of "accredited investors"; and
- Proposed rules on "finders" in the capital raising context and the framework for issuance of "compensatory securities".

Impact of COVID-19 on Proxy Statement Disclosures

In 2020, companies faced the effects of the global COVID-19 pandemic, and related disclosure considerations. The effects of the ongoing pandemic, and its effect on all aspects of business operations, will continue to be woven into many disclosures in 2021.

Compensation disclosures: While there have not been updates to compensation disclosure rules for the 2021 proxy season, circumstances surrounding the pandemic may lead to disclosures companies may not be required to make in a typical year. For example, if an executive officer has chosen to receive equity or other non-cash compensation in lieu of salary or bonus, the summary compensation table still must include an explanation regarding the compensation. Additionally, changes to performance targets as a result of the pandemic must be disclosed and discussed, where applicable.

Additionally, although the Compensation Discussion and Analysis (CD&A) section only needs to discuss named executive officer compensation, some companies may choose to discuss overall workforce compensation changes related to COVID-19 in the context of compensation decisions for executives.

Finally, the SEC has issued compliance interpretations regarding whether benefits provided to executive officers because of the pandemic are perquisites or personal benefits for purposes of compensation disclosure. This determination requires a two-step analysis that is fact-specific. For example, enhanced technology for use during a stay-at-home order generally would not be a perquisite or personal benefit, but personal transportation benefits that may not be available to all employees would likely be a perquisite or personal benefit.

Corporate governance: Item 407(h) of Regulation S-K requires companies to "disclose the extent of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function." In the 2021 proxy season, this requirement would include a description of how the board oversaw the challenges presented by COVID-19, as well as how management responded to the pandemic.

Audit committee reports: While Regulation S-K only requires specific disclosures in audit committee reports, many companies voluntarily include additional disclosures. COVID-19 has presented unique audit-related challenges. The Public Company Accounting Oversight Board (PCAOB) recently summarized its discussions with audit committee chairs and identified the risks related to the shift to a remote workforce as a primary concern for many companies. Audit committees may also have new concerns to discuss with their auditors, including whether any audit procedures or disclosures need to change as a result of COVID-19.

Human capital: The pandemic has raised unique human capital concerns, including the health and safety of employees and customers, issues related to remote working, succession planning, and business continuity. In 2020, protests over racial and social injustice advanced discussions regarding workplace discrimination and related issues.

Proxy statements require diversity and pay ratio disclosure, as well as board oversight disclosure. Additionally, as discussed below, the SEC recently amended Regulation S-K to include additional business description requirements

Virtual meetings: During the 2020 proxy season, the COVID-19 pandemic greatly increased companies' usage of virtual shareholder meeting formats. In some cases, meetings were conducted entirely virtually, with no in-person component. In other cases, in-person meetings were conducted with supplemental audio and/or video options. To some extent, this reliance on virtual meetings is expected to continue.

Companies considering conducting their 2021 shareholder meeting virtually should assess which options may be appropriate for them and they should begin planning the technical aspects and procedures of such meetings, as well as the disclosures required to notify shareholders of the meeting.

Meeting procedures, including the permissibility of virtual meetings, are governed by applicable state law, as well as a company's governing documents. Companies should review these requirements prior to arranging a virtual meeting.

Other Proxy Statement Considerations

Environmental, social and governance (ESG): ESG factors have become increasingly important disclosure topics in recent years. The COVID-19 pandemic has made some of these factors, including employee health and safety and remote working issues, more prominent. Additionally, the increased focus on racial and social justice disclosure is expected to continue.

Several large institutional investors have published proxy voting and engagement guidelines addressing ESG issues, and some organizations rate companies based on their ESG practices and disclosures. Additionally, there are several third-party frameworks that companies increasingly rely upon in making their ESG disclosures.

Companies should take care to ensure their ESG disclosures are not inaccurate or misleading. For example, it may be more appropriate to frame ESG goals as aspirational, rather than as completed achievements, to avoid misleading investors as to a company's progress in those areas. ESG disclosures should be carefully fact-checked and companies may consider including a disclaimer.

Pay ratio disclosure: The pay ratio rule requires disclosure of the ratio of the annual total compensation of a company's median employee to that of its chief executive officer. Typically, companies must only identify their median employee once every three years, as long as the company reasonably believes there have been no changes that would significantly affect the disclosure. This year, when many companies have been faced to furlough or lay off employees or reduce employee pay, more companies may determine that they need to newly identify their median employee. For companies that choose to use the same median employee, the proxy statement should disclose the reason for the company's belief that there have not been any changes.

Perks: Disclosure of perquisites continues to be a focus of the SEC, as demonstrated by the SEC's recent institution of enforcement proceedings against a company for failure to disclose perquisites paid to its chief executive officer. In addition to the disclosure shortcomings violation, the SEC noted the failure of the company's internal controls related to such payments. This case serves as a reminder to companies that they need to accurately disclose, and provide adequate controls for, perquisites paid on behalf of their named executive officers.

Shareholder proposals: The SEC has amended its procedural requirements for submission and resubmission of shareholder proposals to be included in a company's proxy statement under Rule 14a-8. As amended, the rule will increase shareholder ownership requirements if the shares have been held for less than three years; increase the required levels of support for matters that have been considered during the last five years; eliminate the ability of a single representative to submit multiple proposals on behalf of different shareholders at a single meeting; and require shareholders to provide information about their ability to meet with the company. These changes are not yet in effect, but will become effective on January 1, 2022.

Proxy voting advice amendments: In July 2020, the SEC amended its proxy solicitation rules designed to enhance he transparency, accuracy and completeness of the information that proxy advisors provide to investors. The amendments codify that voting advice produced by proxy advisors generally constitutes a solicitation under the proxy rules. The amended Rule 14a-2(b)(9) also adds new conditions to the exemptions that proxy advisors have relied upon in the past.

As a result of the amendments, proxy advisors will have to disclose conflicts of interest in their proxy voting advice, establish procedures to allow all companies subject to their advice to be able to access the advice at the same time as clients, and provide a mechanism for clients to access any written company response to their voting advice before they vote. These conditions do not take effect until December 1, 2021 and will not affect the upcoming proxy season.

Updated Reporting and Disclosure Requirements

COVID-19 disclosures: The SEC Staff has issued CF Disclosure Guidance: Topic No. 9 and CF Disclosure Guidance: Topic No. 9A, providing guidance regarding disclosure considerations for companies with respect to COVID-19. Companies should review this guidance as they evaluate the impact of the COVID-19 pandemic on the following annual report topics.

Risk factors: There are many ways in which COVID-19 may pose risks that companies should consider in preparing risk factors. These considerations may include declining revenues, liquidity challenges, cybersecurity concerns raised by remote work arrangements, and other uncertainties related to the pandemic. Companies should review and update their COVID-19 specific risk factor in preparation for filing their annual report.

In addition to COVID-19, there are other important topics companies should consider in updating their risk factors, including cybersecurity, the LIBOR transition, and IP and technology risks.

Critical audit matters: Large, accelerated filers already must include disclosure of Critical Audit Matters (CAMs) or a statement that the auditor determined there were no CAMs. CAM provisions are now effective to all other companies to which the disclosure requirements apply. Any matter arising from the audit of financial statements that is required to be communicated to the audit committee will be a CAM if it both relates to material accounts or disclosures and involves an especially challenging, subjective, or complex auditor judgment.

MD&A: In addition to considering the impact of COVID-19 in the MD&A, companies should also review the MD&A guidance that was issued in January 2020 regarding key performance indicators and metrics used in the MD&A. Specifically, the guidance provides that, where companies disclose metrics, they should consider whether additional disclosures are necessary and gives examples of such disclosures. It also reminds companies of the requirements in Exchange Act Rules 13a-15 and 15d-15 to maintain disclosure controls and procedures, and that companies should consider these requirements when disclosing metrics.

Amendments to business, risk factor and legal Regulation S-K items: In August 2020, for the first time in more than 30 years, the SEC adopted amendments to Regulation S-K that are intended to modernize business (Item 101), risk factor (Item 105) and legal proceedings (Item 103) disclosures.

- **Item 101 - description of business**: The amendments revise Item 101(a) to be primarily principles-based, requiring disclosure of information material to an understanding of the general development of the business, and eliminating the previous five-year timeframe for the general description of the development of the company's business. Item 101(h) has also been revised to eliminate the three-year timeframe for smaller reporting companies. The amendments to Item 101(c) will require a company to disclose a description of the company's human capital resources to the extent material to an understanding of the company's business. The amendments also revise the regulatory compliance disclosure requirement to include compliance with all material government regulations, not only environmental laws.

• **Item 103 - material legal proceedings**: Item 103, which requires disclosure of material legal proceedings, has been amended to allow disclosure of information by hyperlink (i.e., an active link within a filing) or cross-reference to other sections of a filing. The threshold in Item 103 for disclosure of environmental proceedings to which the government is a party has been revised from $100,000 to $300,000.

• **Item 105 - risk factors**: Item 105, which requires a company to disclose the most significant factors that may make an investment in the company speculative, has also been amended. For risk factors sections exceeding 15 pages, a new summary risk factor disclosure of no more than two pages will be required. Companies will also be required to disclose "material" risk factors, as well as organize risk factors under relevant headings. While the amendments do not define "material," the SEC's discussion of the final rule acknowledges that "materiality is a broad concept that encompasses both investment and voting decisions."

These amendments are effective now.

Amendment to modernize and enhance MD&A and financial disclosures: In November, 2020, the SEC adopted amendments to Items 301, 302 and 303 of Regulation S-K by eliminating Item 301 (selected financial data), then modernizing, simplifying and streamlining Item 302(a) (supplementary financial information) and Item 303 (MD&A). Specifically, these amendments:

• Revise Item 302(a) to replace the current requirement for quarterly tabular disclosure with a principles-based requirement for material retrospective changes;

• Add a new Item 303(a), Objective, to state the principal objectives of MD&A;

• Amend current Item 303(a)(1) and (2) to modernize, enhance and clarify disclosure requirements for liquidity and capital resources;

• Amend current Item 303(a)(3) to clarify, modernize and streamline disclosure requirements for results of operations;

• Add a new Item 303(b)(3), Critical Accounting Estimates, to clarify and codify Commission guidance on critical accounting estimates;

• Replace current Item 303(a)(4), Off-balance Sheet Arrangements, with an instruction to discuss such obligations in the broader context of MD&A;

• Eliminate current Item 303(a)(5), Tabular Disclosure of Contractual Obligations, in light of the amended disclosure requirements for liquidity and capital resources and certain overlap with information required in the financial statements; and

• Amend current Item 303(b), Interim Periods (amended Item 303(c)), to modernize, clarify and streamline the item and allow for flexibility in the comparison of interim periods to help registrants provide a more tailored and meaningful analysis relevant to their business cycles.

Registrants are required to comply with the amendments beginning with the first fiscal year ending on or after the date that is 210 days after publication in the Federal Register (the "mandatory compliance date"). Registrants will be required to apply the amended rules in a registration statement and prospectus that on its initial filing date is required to contain financial statements for a period on or after the mandatory compliance date. Although registrants will not be required to apply the amended rules until their mandatory compliance date, they may comply with the amendments any time after the effective date, so long as they provide disclosure responsive to an amended item in its entirety.

Amendments to acccelerated and large accelerated filer definitions: In March 2020, the SEC voted to adopt amendments to the "accelerated filer" and "large accelerated filer" definitions in Rule 12b-2 under the Exchange Act. The amendments tailor the types of issuers that are included in the categories of accelerated and large accelerated filers, and include the following changes:

• Add a revenue / investment income condition to the accelerated and large accelerated filer definitions;

• Increase the public float transition thresholds for accelerated (from $50 million to $60 million) and large accelerated filers (from $500 million to $560 million);

• Add a revenue test to the transition thresholds for accelerated and large accelerated filers; and

• Add a check box to indicate whether an ICFR auditor attestation is in a filing.

For Financial Institutions, Industry Guide 3 Replaced with Subpart 1400 of Regulation S-K
In September 2020, the SEC adopted rules to update and expand the statistical disclosures that bank and savings and loan registrants provide to investors. The new rules replace Industry Guide 3, Statistical Disclosure by Bank Holding Companies, with updated disclosure requirements into a new Subpart 1400 of Regulation S-K. The rules eliminate certain disclosure items that are duplicative of other SEC rules and requirements of U.S. GAAP or IFRS, and are the first substantive changes to the statistical disclosure requirements for financial institutions in more than 30 years. Additionally, while the current Guide 3 guidelines represent SEC staff policies and practices, the codification of the rules in Subpart 1400 will elevate them from guidance to SEC rules.

Subpart 1400 will require disclosure about the following:

• Distribution of assets, liabilities and stockholders' equity, the related interest income and expense, and interest rates and interest differential;

• Weighted average yield of investments in debt securities by maturity;

• Maturity analysis of the loan portfolio, including the amounts that have predetermined interest rates and floating or adjustable interest rates;

• Certain credit ratios and the factors that explain material changes in the ratios, or the related components during the periods presented;

• The allowance for credit losses by loan category; and

• Bank deposits, including average amounts and rate paid and amounts that are uninsured.

Among the notable changes in these areas are:

• Reporting periods for statistical disclosure will be tied to the annual reporting periods of the relevant financial statement requirements;

• Item 1405 will require the disclosure of the following credit ratios, along with each of the components used in their calculation: (1) allowance for credit losses to total loans; (2) nonaccrual loans to total loans; (3) allowance for credit losses to nonaccrual loans; and (4) net charge-offs to average loans. A discussion of the factors that drove material changes in the ratios, or related components, will be required. Although not required under the existing requirements, many bank registrants already include the new required credit ratio disclosures in their SEC filings as the components are required under regulatory reports; and

• Item 1404 will codify currently required maturity and interest rate sensitivity disclosure, but would expand disclosure to each category of loans required to be disclosed under U.S. GAAP or IFRS financial statements. Interest rate sensitivity has, since 1997, been covered by the SEC's market risk disclosure rule.

The new rules will apply to fiscal years ending on or after December 15, 2021. However, the SEC will accept voluntary compliance before the mandatory compliance date.

NASDAQ Proposed Rule - Diversity

In December 2020, NASDAQ filed a proposal with the SEC to adopt new listing rules regarding board diversity and disclosure. If approved, the new listing rules would require all companies listed on NASDAQ's U.S. exchange to publicly disclose consistent, transparent diversity statistics regarding their board of directors. The proposal includes an analysis of over two dozen studies that found an association between diverse boards and better financial performance and corporate governance.

The rules also would require most NASDAQ-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+. Smaller reporting companies (as well as foreign companies) would have additional flexibility in satisfying this requirement with two female directors.

Important Developments in the Private Offering Context

Accredited investor definition: In August 2020, the SEC amended the definition of an accredited investor (an important classification for eligibility to participate in certain private offerings) to allow investors to qualify as accredited investors based on defined measures of professional knowledge, experience or certifications in addition to the existing tests for income or net worth. The amendments also expand the list of entities that may qualify as accredited investors, including by allowing any entity that meets an investments test to qualify.

Exempt offering framework: In November 2020, the SEC adopted amendments to its rules to attempt to "harmonize" its framework for exempt offerings. Specifically, the amendments generally:

• Establish, in one broadly applicable rule, the ability of issuers to move from one exemption to another;

• Increase the offering limits for Regulation A, Regulation Crowdfunding, and Rule 504 offerings, and revise certain individual investment limits;

• Establish rules governing certain offering communications, including permitting certain "test-the-waters" and "demo day" activities; and

- Harmonize certain disclosure and eligibility requirements and bad actor disqualification provisions.

Finders exempt from broker registration: In October 2020, the SEC proposed a new exemption from broker registration requirements for "finders" who assist issuers with raising capital from accredited investors in private offerings. The proposed exemption remains fairly restrictive in the activities permitted and establishes two categories of finders, Tier I and Tier II, that are subject to conditions tailored to the scope of their activities.

Compensatory securities offerings: In November 2020, the SEC proposed amendments to its rules to, among other things, address the disclosure requirements in the context of exempt "compensatory offerings" for employees, consultants and advisers and increase two of the 12-month dollar ceilings for such offerings.

If you have any questions on any of these new or amended regulations, please contant Paul Mattaini, Kimberly Decker or Amanda Jabour Kowalski, or anyone in our Securities Practice Group.

:

Paul G. Mattaini

Partner

Tel: (717) 399-1519

Email: pmattaini@barley.com

Kimberly J. Decker

Partner

Tel: (717) 399-1506

Email: kdecker@barley.com

Amanda Jabour Kowalski

Counsel

Tel: (717) 399-1515

Email: akowalski@barley.com