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Choice Act 2.0: Key Capital Markets and Securities Law Provisions

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Capital Markets and Securities

On April 19, 2017, the House Financial Services Committee (the "Committee") released a new "discussion draft" of the Financial CHOICE Act ("CHOICE Act 2.0"), its comprehensive regulatory reform bill aimed at revising or repealing many features of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The Committee released the first version of the bill in June 2016.

Prospects for enactment of the CHOICE Act 2.0 are dim, at best. In its omnibus form, the bill is not expected to have substantial, if any, bipartisan support, and in the Senate, the legislative filibuster probably dooms its fate. However, it is possible that discrete pieces of the bill could have bipartisan appeal and thus might be able to be passed separately, and perhaps in short order.

This client alert summarizes some of the more noteworthy provisions that would affect the securities laws and regulation of capital markets. The bill also includes significant changes to the regulation of banks and other financial institutions, which we described in our client alert published on April 24, 2017.

Executive Compensation and Corporate Governance

Section	Topic	Commentary
843	Say-On-Pay and Say-On-Frequency *Legislative source: Dodd-Frank Section 951*	Section 843 would amend Section 14A(a) of the Securities Exchange Act of 1934 (the "Exchange Act") to require a say-on-pay vote each year in which there has been a "material change" to executive compensation from the previous year. Currently, the Exchange Act requires say-on-pay votes at least once every three years, regardless of the materiality of changes in executive compensation. It is unclear how a "material change" in executive compensation would be defined, but the SEC or its staff could provide guidance to issuers if the law is changed. Presumably, companies could continue to hold annual say-on-pay votes, if desired, as has become the prevailing practice. Section 843 would also

		remove the provision of the Exchange Act that requires issuers to hold advisory shareholder votes at least every six years on the frequency of say-on-pay votes.
849	Clawback of Executive Compensation *Legislative source: Dodd-Frank Section 954*	Section 10D of the Exchange Act, added by Dodd-Frank, requires national securities exchanges to have listing standards under which listed companies must implement clawback policies to recover incentive-based compensation from any current or former executive officer, if such compensation was based on financial metrics that are subsequently restated. Section 849 would limit this clawback obligation to those executive officers who had *control or authority* over the financial reporting resulting in the restatement.[1]
857	Pay Ratio Disclosure *Legislative source: Dodd-Frank Section 953(b)*	Section 857 would repeal Section 953(b) of Dodd-Frank, which directed the SEC to amend Item 402 of Regulation S-K to require disclosure of (i) the median of the annual total compensation of all employees of a registrant (excluding the chief executive officer), (ii) the annual total compensation of the chief executive officer, and (iii) the ratio of the median annual total compensation of all employees to the annual total compensation of the chief executive officer. The SEC adopted a pay ratio rule in August 2015, which will require new disclosures in proxy statements filed in 2018.[2] The bill does not, however, directly affect the validity of the SEC's rule or direct the SEC to reconsider or repeal the rule.
	Hedging Policy Disclosure *Legislative source: Dodd-Frank Section 955*	Section 857 would also repeal Section 955 of Dodd-Frank, which amended the Exchange Act to require the SEC to adopt rules requiring disclosure about whether a registrant's directors and employees are permitted to engage in transactions that hedge or

[1] On July 1, 2015, the SEC approved a Proposed Rule to implement the clawback requirements of Section 954 of Dodd-Frank, which remains pending. For a more in-depth discussion of the clawback Proposed Rule, please refer to this Covington Alert published on July 6, 2015.
[2] For a more in-depth discussion of the SEC's pay ratio rule, please refer to this Covington Alert published on August 10, 2015.

		offset any decrease in the market value of the registrant's equity securities.[3]
	Incentive-Based Compensation at Financial Institutions *Legislative source: Dodd-Frank Section 956*	Section 857 would also repeal Section 956 of Dodd-Frank, which requires a number of federal regulators, including the SEC, to jointly issue regulations or guidelines regarding incentive-based compensation practices at specific types of financial institutions that have $1 billion or more in assets. Among other things, the required regulations or guidelines would prohibit incentive-based compensation arrangements that encourage inappropriate risks to covered financial institutions (i) by providing excessive compensation, fees or benefits, or (ii) that could lead to material financial loss.[4]
	Disclosures Regarding Chair/CEO Structure *Legislative source: Dodd-Frank Section 972*	Lastly, Section 857 would repeal Section 972 of Dodd-Frank, which requires disclosure in annual proxy statements as to why an issuer has chosen the same or different individuals to serve as chairman of the board of directors and chief executive officer. The substance of this disclosure requirement is already in place in Item 407(h) of Regulation S-K, which was on the books well before the enactment of Dodd-Frank.

Proxy and Related Items

Section	Topic	Commentary
844	Shareholder Proposals	*Holding Requirement* Section 844 would direct the SEC to amend its rule governing shareholder proposals to tighten the requirements for submitting shareholder proposals in two ways. First, it would eliminate the option to satisfy the holding requirement by holding a specified dollar amount of the registrant's securities, which is currently only $2,000. This means a shareholder

[3] On February 9, 2015, the SEC approved a Proposed Rule to implement the hedging policy disclosure requirement of Section 955 of Dodd-Frank, which remains pending. For a more in-depth discussion of the Proposed Rule, please refer to this Covington Alert published on February 10, 2015.
[4] On May 6, 2016, the SEC (jointly with other regulators) approved an updated Proposed Rule to implement the incentive-based compensation provisions of Section 956 of Dodd-Frank, which remains pending. For a more in-depth discussion of the Proposed Rule, please refer to this Covington Alert published on April 27, 2016.

		would be required to hold at least one percent of the registrant's outstanding shares in order to submit a proposal. Second, the required holding period would be lengthened from one year to three. *Resubmissions* Section 844 would also increase the thresholds applicable to the resubmission of a shareholder proposal. Currently, if a shareholder proposal deals with substantially the same subject matter as one or more shareholder proposals that were included in a company's proxy materials within the previous five calendar years, the company may exclude it from its proxy materials for any meeting held within three calendar years of the last time it was included if the previously submitted proposals received less than the following levels of shareholder support: (i) less than three percent of the vote if voted on once within the preceding five calendar years, (ii) less than six percent of the vote if voted on twice within the preceding five calendar years, or (iii) less than 10 percent of the vote if voted on three times or more within the preceding five calendar years. The bill would increase these resubmission thresholds to six percent, 15 percent, and 30 percent, respectively, making it more difficult for shareholders to resubmit proposals within any five-year period. *Shareholder Proposals by Proxies* Section 844 would also prohibit an issuer from including in its proxy materials a shareholder proposal submitted by a person in such person's capacity as a proxy, representative or agent.
845	Universal Proxy	Section 845 would amend the Exchange Act to prohibit the SEC from adopting a "universal proxy" rule, which would require that a company include in its proxy materials the names of any nominees of an insurgent group in the context of a proxy contest.[5]

[5] On October 26, 2016, the SEC approved a Proposed Rule to require the use of universal proxies, which remains pending. For a more in-depth discussion of the Proposed Rule, please refer to this Covington Alert published on December 6, 2016.

Capital Markets and Related Items

Section	Topic	Commentary
452	General Solicitation	Section 452 seeks to address concerns regarding limitations on communications at so-called "pitch days." It would require the SEC to revise Regulation D to provide a safe harbor from the prohibition on the use of "general solicitation" or "general advertising" in a private placement under Regulation D, in offerings solely to accredited investors, for presentations or other communications made by or on behalf of an issuer at a "pitch day," which the bill defines as an event sponsored by specified entities, including (i) the U.S. or any state or territory or any political subdivision or agency or public instrumentality thereof, (ii) a college, university or other institution of higher education, (iii) a nonprofit organization, (iv) an angel investor group, or (v) a venture forum, venture capital association, or trade association. In order to comply with the requirements of the safe harbor, the advertising for any such event may not reference any specific offering of securities by the issuer, and any communication at the event that addresses the offering must be limited to the following: (i) that the issuer is in the process of offering or planning to offer securities, (ii) the type and amount of securities being offered, (iii) the amount of securities being offered that have already been subscribed for, and (iv) the intended use of proceeds of the offering.
466	Private Placement Notice Filing Requirements	Section 466 would require the SEC to revise the Form D filing requirements to require an issuer relying on Rule 506 of Regulation D to file a single notice of sales containing the information required by Form D for each new offering of securities no earlier than 15 days after the date of the first sale of securities in the offering. Currently, Rule 503 of Regulation D requires an issuer to file amendments to a previously-filed Form D for an offering to reflect certain changes in the information presented in such Form D. In addition, Section 466 would not allow the SEC to condition the availability of any exemption under Rule 506 on the issuer's filing of a Form D.

461	Registration Exemption for "Micro-Offerings"	Section 461 would add a new exemption to Section 4 of the Securities Act of 1933, as amended (the "Securities Act") for "micro-offerings." In order to qualify as a micro-offering each purchaser must have a substantive pre-existing relationship with an officer, director, or greater than 10 percent shareholder of the issuer. In addition, there must be no more than 35 purchasers. Finally, the aggregate amount of all securities sold by the issuer, including any amount sold in reliance on the micro-offerings exemption, during the 12-month period preceding such transaction cannot exceed $500,000.
499	Reduced Capital Market Regulations	Section 499 would expand the availability of two important capital markets enhancements added by the Jumpstart Our Business Startups Act (the "JOBS Act"), which currently are available only to emerging growth companies. First, the "testing the waters" flexibility on pre-offering communications provided in Section 5(d) of the Securities Act would be extended to all issuers. Second, the mechanism in Section 6(e) of the Securities Act permitting the confidential submission of draft registration statements for confidential nonpublic review by the staff of the SEC prior to public filing would be extended to all first-time registrants.
406	Expanded Registration Exemption for Issuances of Securities to Employees Under Compensatory Benefit Plans	Rule 701 under the Securities Act provides an exemption from the registration requirements of the Securities Act for issuances of securities by non-reporting issuers to employees and others pursuant to written compensatory benefit plans. Rule 701(e) requires the issuer to provide specified disclosure, including financial statements, if the issuer has sold more than $5 million of securities during any consecutive 12-month period. Section 406 would increase this threshold to $20 million.
426	Expanded Eligibility for Use of Short-Form Registration	Section 426 would expand Form S-3 eligibility by allowing securities to be registered in a primary offering on such form so long as the registrant has at least one class of common equity securities listed and registered on a national securities exchange. Section 426 would add this as an alternative avenue of S-3 eligibility, in addition to the current condition for S-3 eligibility that the aggregate market value of the voting

		and non-voting common equity of the registrant held by non-affiliates exceeds $75 million.

Other Items

Section	Topic	Commentary
411	XBRL	Section 411 would exempt emerging growth companies from the XBRL requirement indefinitely. In addition, Section 411 would exempt issuers with gross annual revenues of less than $250 million from the XBRL requirement for a period of (i) five years after the date the CHOICE Act 2.0 is enacted or (ii) two years after the SEC determines that the benefits of the XBRL requirements to issuers outweigh the costs, but in any event no earlier than three years after the enactment of the CHOICE ACT 2.0.
497	Raised Thresholds for Exchange Act Registration and Deregistration	Section 12(g) of the Exchange Act establishes the thresholds at which an issuer is required to register a class of equity securities with the SEC. Currently, an issuer that is not a bank, bank holding company, or savings and loan holding company is required to register a class of equity securities under the Exchange Act if (i) it has more than $10 million in total assets and (ii) the securities are held of record by either 2,000 persons or 500 persons who are not accredited investors. Section 497 would eliminate the threshold that pertains to accredited investors, resulting in a single, 2,000-person threshold, whether or not the holders are accredited investors. Section 497 would also amend Section 12(g)(4) of the Exchange Act to raise the threshold for permitting all issuers to terminate the registration of a class of equity securities under Section 12(g) from 300 to 1,200 holders. This same increase in threshold would also apply to the automatic suspension of an issuer's reporting obligations pursuant to Section 15(d) of the Exchange Act.
847 and 441	Reduced Involvement by Auditors in Internal Control Over Financial Reporting	Currently, Item 308 of Regulation S-K exempts non-accelerated filers from the obligation to provide an auditor's attestation report on the company's internal

		control over financial reporting.[6] Section 847 would amend Section 404(c) of the Sarbanes-Oxley Act of 2002 to extend this exemption to any issuer with a total market capitalization of less than $500 million, as well as any issuer that is a depositary institution with assets of less than $1 billion. In addition, Section 441 would provide a temporary exemption for low-revenue issuers (less than $50 million) to continue to take advantage of the current emerging growth company exemption from the auditor attestation requirement.
862	Conflict Minerals *Legislative source: Dodd-Frank Section 1502*	Section 862 would repeal Section 1502 of Dodd-Frank, which requires public companies with products containing specified "conflict minerals" to investigate their supply chains to ascertain whether any such minerals originated in the Democratic Republic of the Congo or an adjoining country, and to provide certain disclosures annually.[7]
	Mine Safety Disclosures *Legislative source: Dodd-Frank Section 1503*	Section 862 would also repeal Section 1503 of Dodd-Frank, which requires any reporting issuer that is a mine operator (or has a subsidiary that is a mine operator) to disclose certain health and safety information in its periodic reports.
	Resource Extraction Issuer Rules *Legislative source: Dodd-Frank Section 1504*	Section 862 would also repeal Section 1504 of Dodd-Frank, which requires reporting issuers engaged in commercial development of oil, natural gas, or minerals to disclosure annually certain payments made to the United States or foreign governments.

[6] A non-accelerated filer is generally a company with a public float of less than $75 million on the last business day of its second fiscal quarter. *See* Rule 12b-2 under the Exchange Act.

[7] On April 7, 2017, the SEC's Division of Corporation Finance (the "Division") issued a statement in response to the entry of final judgment on April 3, 2017 in the long-running legal challenge to the conflict minerals reporting rule. For a more in-depth discussion of the Division's statement and for additional background on the legal challenge to the conflict minerals reporting rule, please refer to this Covington Alert published on April 17, 2017.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Capital Markets and Securities practice:

David Engvall	+1 202 662 5307	dengvall@cov.com
Sarah Griffiths	+1 212 841 1013	sgriffiths@cov.com
Keir Gumbs	+1 202 662 5500	kgumbs@cov.com
Reid Hooper	+1 202 662 5984	rhooper@cov.com
David Martin	+1 202 662 5128	dmartin@cov.com