

Recent Federal Securities Regulatory and Other Developments

March 27, 2015

Securities

This advisory covers recent developments in the securities regulatory area, including proposed rule amendments regarding the registration of classes of equity securities under the Securities Exchange Act of 1934 (the “Exchange Act”) and disclosure of hedging policies, certain proxy-related matters and the activities of two advisory committees to the Securities and Exchange Commission (the “SEC”).

Proposed Amendments to the Rules for Exchange Act Registration and Hedging Disclosure

Registration Requirements

On December 18, 2014, the [SEC proposed rule amendments](#) to incorporate the new and more lenient Exchange Act thresholds for registering classes of equity securities enacted by the Jumpstart Our Business Startups Act (the “JOBS Act”). The comment period for the proposed amendments ended on March 2, 2015.

The Proposed Amendments

In 2012, the JOBS Act amended Section 12(g)(1) of the Exchange Act to raise the trigger for registration of classes of equity securities. The new registration threshold is triggered if an issuer, on the last day of its fiscal year, has total assets of more than \$10 million and a class of equity securities is “held of record” by either (i) 2,000 persons, or (ii) 500 persons who are not “accredited investors.” Prior to this amendment, the threshold for registration had been 500 record holders, regardless of accredited investor status.¹

The recent proposed amendments would harmonize existing SEC rules with the new thresholds established by the JOBS Act by updating Exchange Act Rules 3b-4, 12g-1, 12g-2, 12g-3, 12g-4, 12g5-1 and 12h-3, as well as Rule 405 pursuant to the Securities Act of 1933 (the “Securities

¹ The JOBS Act also established a separate registration threshold for banks and bank holding companies. The threshold applicable to banks and bank holding companies is 2,000 persons, regardless of accredited investor status. While the JOBS Act did not modify the deregistration threshold for other companies, banks and bank holding companies with less than 1,200 holders of record are now eligible to deregister under Section 12(g) of the Exchange Act, as amended by the JOBS Act.

Act”).² In the process, the SEC declined to establish a new definition of “accredited investor,” which is currently under review by the SEC staff, and instead chose to rely on the existing definition in Rule 501(a) under the Securities Act.

“Held of Record”

The JOBS Act amendment to the Exchange Act excludes from the definition of “held of record,” any securities held by persons who received the securities under an “employee compensation plan” in transactions exempted from the registration requirements of Section 5 of the Securities Act. The SEC’s proposal codifies this provision, which had been self-executing under the JOBS Act, by amending the definition of “held of record” in Exchange Act Rule 3b-4 to exclude securities (i) received under an employee compensation plan in transactions exempt from the registration requirements of the Securities Act or (ii) that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act.³

Additionally, the SEC proposes to establish a non-exclusive safe harbor in Exchange Act Rule 12g5-1 that relies on the existing definition of “compensatory benefit plan” in Rule 701 and the conditions in Rule 701(c). This safe harbor would be available to holders of securities received in other employee compensation plan transactions exempted from the registration requirements of Section 5 of the Securities Act, such as securities issued in reliance on Section 4(a)(2) of the Securities Act or Regulation D and Regulation S under the Securities Act.

Hedging Disclosure

On February 9, 2015, the [SEC proposed a rule amendment](#) as required by Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). If adopted, the amendment would require new disclosure related to the hedging practices of a company that has a class of equity securities registered under Section 12 of the Exchange Act.⁴ The purpose of the proposed rule amendment, according to the SEC, is to elicit disclosure regarding whether employees or directors are permitted to engage in transactions that mitigate or avoid the incentive alignment associated with equity ownership. The comment period for the proposed amendment ends on April 20, 2015.

The Proposed Amendment

In 2010, the Dodd-Frank Act added a new Section 14(j) to the Exchange Act directing the SEC to require issuers to disclose whether their employees and directors are permitted to hedge or offset any decrease in the market value of equity securities granted to them as compensation or held, directly or indirectly, by them. This disclosure is required to be in any proxy or consent solicitation material for an annual meeting of shareholders. The SEC has proposed to

² The SEC’s proposed rules extend the thresholds applicable to banks and bank holding companies to include savings and loan holdings companies.

³ Many issuers issue securities to employees without Securities Act registration on the basis that the issuance is not a sale under Section 2(a)(3) of the Securities Act.

⁴ Voluntary filers, debt-only filers and companies that file reports only under Section 15(d) of the Exchange Act would not be subject to the proposed amendment.

implement this by adding a new paragraph (i) to Item 407 of Regulation S-K that applies to proxy or information statements relating to an election of directors, whether by vote of security holders at a meeting or an action authorized by written consent. The disclosure under this new paragraph (i) would be required in the same instances as other Item 407 corporate governance disclosures.⁵

The proposed amendment requires disclosure regarding whether a company permits any directors, officers or other employees to engage in hedging. The amendment would not, however, prohibit such transactions. The disclosure is designed to identify features of policies regarding hedging -- i.e. the persons covered and not covered and the categories of transactions that are permitted or not permitted.⁶ Information disclosed under the proposed amendment would not be deemed to be "filed," which means that it would not be part of a registered securities offering, except to the extent specifically incorporated by reference.

There is a current disclosure obligation relating to a company's hedging policies in Item 402(b) of Regulation S-K, which requires such disclosure in the company's Compensation Discussion and Analysis ("CD&A"). In order to reduce potentially duplicative disclosure in proxy and information statements, the SEC is also proposing a new instruction to Item 402(b) of Regulation S-K providing that, to the extent the information disclosed under new Item 407(i) satisfies the CD&A obligation to disclose material policies on hedging by named executive officers, companies may elect to cross-reference the new Item 407(i) disclosure in the CD&A.⁷

Practical Implications

Studies have generally found that a large number of companies already disclose the existence of hedging policies, which suggests that the proposed amendments will not meaningfully expand the disclosure practices of many public companies.⁸ However, the proposed amendment applies to a broader set of securities (e.g., the registered equity securities of a company's subsidiary, parent and certain other affiliated companies) than those covered by many existing policies. Also, the proposal requires that companies specify the persons and transactions to which the hedging policies apply and do not apply, which may be broader than some current disclosures. Therefore, we expect that companies will have to expand their hedging policy disclosures in some respects if the proposed amendment is adopted.⁹

⁵ Disclosure would not be required in annual reports on Form 10-K or in registration statements filed under the Securities Act or the Exchange Act.

⁶ The proposed amendment covers a range of hedging transactions, including purchases of financial instruments or other transactions that are designed to have the effect of hedging or offsetting any decrease in the market value of equity securities. This is intended to cover all transactions that establish downside price protection.

⁷ Utilizing such a cross-reference, however, would make the disclosure subject to say-on-pay votes.

⁸ For example, a study by Compensation Advisory Partners showed that 91% of companies already disclose the existence of hedging policies.

⁹ Many companies include hedging prohibitions in their insider trading policies. These hedging prohibitions are not always applied to all employees and may be limited to directors and executive

Additionally, the proposed amendment focuses on hedging transactions that are permitted, while most policies focus on transactions that are prohibited or discouraged. Technically, transactions that are not specifically prohibited, as well as transactions that are simply discouraged, would be permitted for the purposes of the proposed amendments. Consequently, companies may need to review their policies to ensure that they would not be required to disclose that certain hedging transactions are permitted solely because they are not specifically prohibited.

Recent Proxy-Related Developments

Proxy Access

Continued focus on shareholders' rights has led to a new wave of efforts seeking to give shareholders the right to include their nominees to the board of directors in a company's proxy statement. To date, close to 100 companies have received proxy access proposals, including 75 of which submitted by the New York City Pension Funds in connection with its so-called Boardroom Accountability Project. The New York City Pension Funds' proposals track the SEC's now-defunct proxy access rule, which would have allowed shareholders that owned 3% of a company's securities for three years to nominate 25% of the board. In addition, certain institutional investors, such as the TIAA-CREF and the California Public Employees Retirement System ("CalPERS"), have initiated a letter writing campaign to encourage companies to adopt proxy access by-laws.

Rule 14a-8 under the Exchange Act provides a process through which shareholders may submit proposals for inclusion in company proxy materials. Under Rule 14a-8, a company must include in its proxy materials such a proposal and related supporting statement if (i) the shareholder complies with specified eligibility and procedural requirements and (ii) the proposal is not excludable under one or more of 13 substantive bases for exclusion in Rule 14a-8(i). If a company believes that a shareholder proposal is excludable under Rule 14a-8(i), the company may seek no-action relief from the SEC staff which, if granted, assures that the SEC staff will not recommend an enforcement action.

Whole Foods No-Action Letter

In September 2014, Whole Foods Market, Inc. ("Whole Foods") received a proxy access proposal from an individual investor. Instead of including the shareholder proposal in its proxy, Whole Foods requested and, in December 2014, obtained a no-action letter from the SEC under Exchange Act Rule 14a-8(i)(9) on the basis that the shareholder proposal directly conflicted with a proxy access proposal that Whole Foods planned to submit for shareholder approval at the 2015 annual meeting. Whole Foods' proxy access proposal differed from the shareholder proposal in several material respects, including: (i) only a single shareholder (but not a group of shareholders) could nominate candidates for election to the board, (ii) the shareholder would be required to have owned 9% or more (versus 3% or more) of its securities for at least five years (versus at least three years) and (iii) only one director or 10% of the board (versus 20% of the board) could be nominated by such shareholder.

officers. The proposed amendments request comment on whether companies should be permitted to determine whether disclosure about all of its employees would be material information for its investors.

The Whole Foods no-action letter and the SEC's analysis of Rule 14a-8(i)(9) subsequently received significant criticism, resulting in a letter-writing campaign led by proxy access proponents. Additionally, as many as 20 companies submitted their own no-action letters seeking similar relief.

Subsequent Moratorium

On January 16, 2015, the SEC released a statement that Chair Mary Jo White had directed the staff to review the application of Rule 14a-8(i)(9) due to "questions that have arisen" about the proper scope and application of the rule. Concurrently with Chair White's statement, the SEC staff withdrew its no-action response to Whole Foods and indicated that it would express no view with respect to arguments under Rule 14a-8(i)(9) for the remainder of the proxy season.

Practical Implications

Despite the limited authority of SEC staff no-action letters, companies and shareholder proponents place weight on the views of the SEC staff. The withdrawal of the no-action letter relief and, more importantly, the suspension of the issuance of no-action letters under this provision of the shareholder proposal rule have caused significant uncertainty among companies and shareholders alike. Of course, since companies are not required to obtain no-action relief from the staff in order to exclude a proposal under Rule 14a-8, those choosing to do so may still either exclude the shareholder proposals outright or seek declaratory relief from the courts.

Many shareholders, such as CalPERS, the California State Teachers' Retirement System, TIAA-CREF, the United Automobile Workers Union pension plan, the Connecticut state pension plan, and the Florida state pension plan, have indicated that they would consider voting against directors at companies that exclude proxy access proposals from their proxy materials. In addition, proxy advisory firms have indicated that they will consider how companies respond to proxy access proposals in making voting recommendations.

Glass, Lewis & Co., LLC ("Glass Lewis"), for instance, will not recommend a vote against directors *solely* because the company at issue proposed a management proposal in lieu of a proxy access shareholder proposal, but it has indicated that it will consider company responses to proxy access proposals on a case-by-case basis, taking into consideration matters such as:

- whether a company's proposal varies materially from the shareholder proposal in minimum ownership threshold, minimum holding period and maximum number of nominees;
- the company's performance and overall governance profile, the board's independence, leadership, responsiveness to shareholders and oversight and the opportunities for shareholders to effect change; and
- the nature of the proponent.

In evaluating these factors, Glass Lewis has indicated that it will review the rationale provided by a company in explaining its reaction to the shareholder proposal, and "in limited cases" may

recommend against a company's directors if the company's rationale is deemed to be insufficient.¹⁰

Institutional Shareholder Services ("ISS") has stated that it generally will recommend a vote against one or more directors if a company omits a properly submitted shareholder proposal when it has not obtained (i) a voluntary withdrawal from the proponent, (ii) no-action relief from the SEC or (iii) a U.S. District Court ruling that allows it to exclude the proposal from its ballot. This recommendation would be given regardless of whether there is a similar management proposal on the ballot. ISS has indicated that where "the company has taken unilateral steps to implement the proposal," it would factor into its assessment the degree of such implementation and any material restrictions added to it.¹¹

Subsequent to the SEC's announcement of the moratorium, at least 14 companies, including some that have resisted such efforts in the past, have voluntarily amended, or have agreed to amend, their by-laws to allow investors owning at least 3% of the company's stock for at least three years the right to nominate a significant portion of their boards.¹² On March 24, 2015, Chair White testified during a congressional hearing that the SEC will be closely tracking the flurry of activity during this proxy season but would not resurrect its efforts to adopt proxy access rules.

Shareholder Proposal Litigation - *Trinity Wall Street v. Wal-Mart Stores, Inc.*

Background

A no-action letter is simply an informal staff position, and although a company may take great comfort in receiving a favorable response to a no-action letter request, it may take no assurance that the staff's view adjudicates the merits of a company's position. This principle played out starkly in litigation involving a recent no-action letter obtained by Wal-Mart Stores, Inc. ("Wal-Mart").

Trinity Wall Street v. Wal-Mart Stores, Inc. deals with the question of whether a shareholder proposal related to the sale of guns with high-capacity magazines may be omitted under the so-called "ordinary business" exclusion in Rule 14a-8(i)(7).¹³ In December 2013, Trinity Wall Street,

¹⁰ See Glass Lewis's full policy guidelines, "Glass Lewis 2015 Proxy Paper Guidelines on Shareholder Initiatives," available at <http://www.glasslewis.com/resource/guidelines>, and "Glass Lewis' Views on Proxy Access Developments," available at <http://www.glasslewis.com/blog/glass-lewis-views-proxy-access-developments/>.

¹¹ See ISS's "Frequently Asked Questions on the Exclusion of Shareholder Proposals," available at <http://www.issgovernance.com/file/policy/2015faquspoliciesonselectedtopics.pdf>

¹² Companies that have amended their by-laws include Boston Properties, Inc., General Electric Company, Hewlett-Packard Company, The Western Union Company and Yum! Brands, Inc.. Others, such as Abercrombie & Fitch Co., Bank of America Corporation, Citigroup Inc., McKesson Corporation and Staples, Inc., have announced plans to implement proxy access this year.

¹³ Rule 14a-8(i)(7) allows a shareholder proposal to be excluded if it deals with matters relating to ordinary business operations and would therefore interfere with the traditional functions of the company's management.

an Episcopal Church parish in New York City, submitted a proposal to be included in Wal-Mart's 2014 proxy materials. The proposal requested that Wal-Mart's Board of Directors amend the charter of its Compensation, Nominating and Governance Committee to add a requirement that the committee:

[provide] oversight concerning the formulation and implementation of, and the public reporting of the formulation and implementation of, policies and standards that determine whether or not [Wal-Mart] should sell a product that:

- specially endangers public safety and well-being;
- has the substantial power to impair the reputation of Wal-Mart; and/or
- would reasonably be considered by many offensive to the family and community values integral to [Wal-Mart's] promotion of its brand.¹⁴

In January 2014, Wal-Mart filed a letter with the SEC, requesting no-action relief from the staff related to the omission of Trinity Wall Street's proposal from its 2014 proxy materials in reliance on Rule 14a-8(i)(7). Trinity Wall Street then filed its own letter with the SEC, which gave its analysis as to why the proposal was not excludable under this rule. The SEC staff, after reviewing the letters from Wal-Mart and Trinity Wall Street, issued a no-action letter in March 2014, confirming that it would not recommend enforcement action if Wal-Mart omitted Trinity Wall Street's proposal from its proxy materials. Following the staff's grant of no-action relief, Trinity Wall Street filed suit in the U. S. District Court for the District of Delaware.

Delaware District Court Opinion

After briefing and oral argument, the district court held that Trinity Wall Street's proposal was not excludable under the ordinary business exclusion.¹⁵ The court found that Trinity Wall Street's proposal did not impede management's ability to conduct Wal-Mart's ordinary business operations because the proposal itself did not dictate the specific policies and standards to be enacted. The proposal would merely require Wal-Mart's Board of Directors to direct, via committee charter amendment, the Compensation, Nominating and Governance Committee's oversight, development and effectuation of a policy that, if adopted, could determine what type of products are sold at Wal-Mart. The proposal did not mandate that Wal-Mart stop selling guns with high-capacity magazines. Rather, it left implementation of any policy adopted by the Board of Directors to Wal-Mart's management.

Additionally, the court found that Trinity Wall Street's proposal raised a significant social policy issue. Prior SEC staff guidance has found that proposals which would otherwise be subject to exclusion under Rule 14a-8(i)(7) may not be permissibly excluded if they also relate to a

¹⁴ The narrative portion of the proposal made clear that these oversight duties would apply to whether Wal-Mart should sell guns with high-capacity magazines. This proposal came in the wake of the deadly gun violence in Aurora, Colorado and Newtown, Connecticut.

¹⁵ Prior to issuing this opinion, the court had denied Trinity Wall Street's request for a preliminary injunction, placing significant weight on the no-action relief granted by the staff. After the denial of this preliminary injunction request, Wal-Mart distributed its proxy materials without Trinity Wall Street's proposal. In this opinion, the court placed much less weight on the no-action relief granted by the staff.

significant social policy issue. However, it is our view that by issuing the no-action relief, the staff did not agree that this proposal involves a significant social policy issue.

The court granted Trinity Wall Street injunctive relief and enjoined Wal-Mart from relying on Rule 14a-8(i)(7) to exclude Trinity Wall Street's proposal from its 2015 proxy materials.

Appeal

Wal-Mart has appealed the ruling of the district court to the United States Court of Appeals for the Third Circuit, filing a brief on January 14, 2015.¹⁶ In its brief, Wal-Mart contends that the district court erred when it ruled in favor of Trinity Wall Street for the following reasons:

- the SEC has previously rejected a standard under which proposals involving matters requiring board action would not be excludable;
- the SEC has previously explained that a shareholder proposal is excludable if the underlying subject matter of such proposal seeks to have a committee review matters of ordinary business; and
- the SEC has stated that a proposal must focus on, rather than merely implicate, a significant policy issue in order to avoid exclusion.

Wal-Mart argues that the SEC's guidance on Rule 14a-8(i)(7) must be given controlling weight unless it is plainly erroneous or inconsistent with the regulation.

On February 4, 2015, Trinity Wall Street filed its brief arguing that its proposal constitutes an appropriate use of a shareholder proposal to provide a company's board with important information about shareholders' financial and nonfinancial concerns. The brief emphasizes that the proposal relates to a significant public policy issue, namely the sale of certain types of guns. Additionally, Trinity Wall Street argues that the proposal accomplishes its goal without limiting the Wal-Mart Board of Directors' authority to exercise business judgment or interfering with the day-to-day operations of the company.

Oral argument on the merits has been scheduled for April 8, 2015.

Proxy Voting Roundtable

On February 19, 2015, the SEC held a roundtable regarding several proxy voting issues. The roundtable considered the desirability of adopting universal ballots for proxy voting, which currently are only available to shareholders who cast their votes in-person at an annual meeting, and also discussed possible ways to increase retail shareholder participation in the proxy voting process.

Universal Proxy Ballots

Under Exchange Act Rule 14a-4(d)(1), in an election of directors, no proxy can give authority to vote for any person who is not a bona fide nominee. A bona fide nominee is defined in Rule

¹⁶ Several *amicus* briefs have been filed on both sides. Covington & Burling LLP was counsel for the *amici curiae* in the brief submitted in support of Wal-Mart on behalf of the American Petroleum Institute, Business Roundtable and U.S. Chamber of Commerce, which can be found [here](#).

14a-4(d)(4) as a person who “has consented to being named in the proxy statement and to serve if elected.” When read in conjunction with state laws that almost universally provide that the most recent proxy revokes all prior proxies, the rule has a practical effect of limiting the ways that voting options in contested director elections may be presented on proxies. More specifically, because one slate’s nominees rarely consent to being named on another slate’s proxy in election contests, shareholders may only vote by proxy for directors on one proxy ballot. This restricts the choice for proxy voters to either the management’s slate or the contesting shareholder’s slate, preventing voters from selecting candidates from both sides. By contrast, if a shareholder attends an annual meeting in person, the shareholder has the freedom to vote for a mix of candidates on a ballot provided at the annual meeting that contains the names of all nominees for the board. SEC Commissioner Luis A. Aguilar stated that this asymmetry is an “anomaly in the Commission’s proxy process rules” that diminishes shareholders’ rights.¹⁷ The roundtable considered whether the SEC should amend its rules to extend the universal ballot to proxy voting.

To frame the discussion, SEC Commissioner Daniel M. Gallagher said that the SEC’s responsibility in this arena is to ensure that the rules “establish a level playing field” in the “relationship between shareholders and management” and that he wanted to consider how universal ballots might affect that balance.¹⁸ To that end, panelists engaged in a discussion that considered both sides of the issue. For example, many cited an inherent unfairness that the current system creates in giving additional choice to shareholders who could attend the meeting in person and suggested that this unfairness defeats the proxy ballot’s purpose of substituting for an in-person vote. Other supporters of the universal ballot noted that shareholders would consider each candidate’s background more closely under a universal proxy ballot, where shareholders would have flexibility to choose individual candidates rather than entire slates. Investor representatives also supported the measure as an effective means of electing a diverse board and approximating true shareholder preferences. However, other panelists were concerned that universal proxy ballots could lead to an increase in the number of proxy fights, which would be both expensive for companies and potentially confusing to shareholders.¹⁹

Finally, panelists raised implementation questions, pointing out that the SEC would need to consider carefully rules for the use of universal proxy cards, including rules regarding features

¹⁷ Commissioner Luis A. Aguilar, Public Statement at the SEC Roundtable on Proxy Voting (February 19, 2015), *Ensuring the Proxy Process Works for Shareholders*, available at: <http://www.sec.gov/news/statement/021915-psclaa.html#.VPcsXvx4rYg>.

¹⁸ Commissioner Daniel M. Gallagher, Public Statement at the SEC Roundtable on Proxy Voting (February 19, 2015), *Ensuring the Proxy Process Works for Shareholders*, available at: <http://www.sec.gov/news/statement/opening-statement-proxy-voting-roundtable-gallagher.html#.VPcpKfx4rYg>.

¹⁹ Prior to the panel, the Center for Capital Markets Competitiveness commented that the universal proxy ballot would turn elections into “political-style campaigns and create dynamics that are not conducive to the effective management of a public company.” Tom Quaadman, Center for Capital Markets Competitiveness, *Re: Roundtable on Proxy Voting* (February 18, 2015), available at: <http://www.sec.gov/comments/4-681/4681-6.pdf>.

such as the placement of candidate names on a proxy card or the overall format of the proxy card, each of which could have significant effects on voting results.

Following the roundtable, the Council of Institutional Investors submitted a comment letter to the SEC, dated March 5, 2015, emphasizing the importance of the issue and urging the SEC to make it a priority.²⁰ The SEC is not obligated to undertake rulemaking in this area, however, and, absent an intervening imperative, it seems unlikely that the SEC would choose to take action in the near term, at least not before addressing a number of other current and likely priorities.²¹

Retail Participation in the Proxy Process

The roundtable also addressed ways to counter low retail investor participation in the proxy process, which, as some panelists suggested, may be attributable to the fact that dissatisfied investors are more likely to sell their shares than expend the time and effort to participate in the proxy process. The panel explored ways to increase retail participation. Some panelists discussed traditional methods of engaging retail investors, such as through phone calls and mailings, which can be effective but expensive. Others suggested alternative solutions, such as providing investors with a summary of the proxy materials or simplifying the language used in order to encourage retail investors to engage with proxy materials.²² Finally, panelists considered adopting technological advances to encourage participation. For example, providing proxy information or institutional voting choices on consumer-friendly sites such as Yahoo! Finance or using programs to generate preliminary proxy selections based on responses to a series of general questions could make the proxy voting process more convenient for retail investors.

²⁰ Council of Institutional Investors, *Re: Proxy Voting Roundtable, File Number 4-681* (March 5, 2015), available at: http://www.cii.org/files/issues_and_advocacy/correspondence/2015/03_05_15_cii_letter%20to%20SEC%20on%20universal%20proxy.pdf.

²¹ To the extent that proxy access gains further momentum and acceptance, however, questions surrounding the implementation of the universal proxy card may grow in importance sooner than expected.

²² The Center for Capital Markets Competitiveness commented that eliminating duplicative information in filings or establishing a process where retail shareholders could provide default advance voting instructions, which could be overridden by the shareholder on a case-by-case basis, could also encourage more retail participation. Tom Quaadman, Center for Capital Markets Competitiveness, *Re: Roundtable on Proxy Voting* (February 18, 2015), available at: <http://www.sec.gov/comments/4-681/4681-6.pdf>.

Recent Activity of the SEC Advisory Committees²³

Investor Advisory Committee

The Investor Advisory Committee was created by the Dodd-Frank Act to advise on a broad range of securities topics, including “initiatives to protect investor interests and to promote investor confidence and the integrity of the securities marketplace.”²⁴ The committee has met several times over the last six months to draft and make recommendations on various issues.

On February 12, 2015, the committee discussed a draft recommendation to shorten trade settlement periods, which refer to the period of time between the occurrence of a transaction and the actual exchange of securities and funds. The draft recommendation would modify current industry practices, shortening the trade settlement period for U.S. equities from three days to one day. This would be in line with European Union equities practices, which adhere to a two-day trade settlement period, as well as government securities and mutual fund practices, which adhere to a one-day settlement period. More importantly, decreasing the trade settlement period would offer risk relief to financial intermediaries, most often financial clearing houses, which bear the risk of either party’s default on its payment or securities delivery obligations during the trade settlement period. Further, shortening the period would benefit all market participants, especially investors, by lowering the systematic risk associated with the period of uncertainty between the execution of the transaction and the delivery of securities and funds.

In addition, on October 9, 2014, the committee made two recommendations to increase impartiality in the disclosure of preliminary proxy voting information. Currently, Rule 14a-2(a)(1), which was promulgated under the Exchange Act, provides brokers with an exemption from the proxy rules if, in addition to meeting other administrative requirements, they forward proxy materials to or solicit voting instructions from the beneficial owner of the securities in an “impartial” manner. However, the committee has observed instances where it believes there are questions as to whether early release of preliminary voting information compromises the principle of impartiality. For example, where an issuer is provided preliminary voting information before a meeting, should such information be provided to others who may be soliciting proxies? Consequently, the committee recommended that brokers who wish to claim an exemption from Rule 14a-2(a)(1) must (i) ensure that they act impartially in the disclosure of voting information and (ii) take steps to verify that any intermediaries, to whom brokers almost always contract the forwarding of proxy materials and solicitation of voting instructions, act impartially as well.

On October 9, 2014, the committee also made a series of recommendations to modify the definition of “accredited investor” in accordance with the Dodd-Frank Act, which requires the

²³ In addition to the activities of the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies discussed below, the SEC also recently formed the Equity Market Structure Advisory Committee, whose members were announced in January 2015. SEC Announces Members of New Equity Market Structure Advisory Committee, U.S. SECURITIES AND EXCHANGE COMMISSION (Jan. 13, 2015), <http://www.sec.gov/news/pressrelease/2015-5.html#.VOdakvnF98F>. This committee has not yet met.

²⁴ Investor Advisory Committee, U.S. SECURITIES AND EXCHANGE COMMISSION, <https://www.sec.gov/spotlight/investor-advisory-committee-2012.shtml>.

SEC to review that definition at least every four years. The term “accredited investor” defines a type of investor that has a favorable status for certain offerings of securities which are exempt from registration under the Securities Act. As applied to natural persons, the current definition of “accredited investor” includes an individual with over \$200,000 in annual income, \$300,000 in joint annual income with a spouse, or a net worth of at least \$1,000,000 (excluding the value of the primary residence). In noting that the current thresholds need improvement, some members of the committee noted that wealth or income does not necessarily signify financial sophistication and that many individuals who meet the current thresholds may nonetheless need the protections that registration and disclosure provide. Further, individuals who cannot meet the net worth or income thresholds may nonetheless be sufficiently sophisticated to forgo the protections of registration and disclosure. In addition, individuals who qualify as accredited investors by meeting the net worth threshold may do so by counting their retirement assets or other illiquid investments. Finally, the current thresholds have not been adjusted for inflation since their establishment in 1982. It was noted that if these threshold amounts were to be adjusted to reflect current values, they would more than double their original figures.

The committee was careful to note that simply increasing threshold amounts would not be enough, however. It recommended that the SEC consider more precise approaches, such as using different thresholds for liquid and illiquid assets, excluding retirement assets, enabling individuals to qualify based on their financial sophistication, or limiting the percentage of assets that an individual could invest. It also recommended that independent third parties, rather than issuers, verify accredited investor status.

Advisory Committee on Small and Emerging Companies

The Advisory Committee on Small and Emerging Companies, which provides the SEC with recommendations relating to emerging companies with less than \$250 million in public market capitalization, has also been reevaluating the definition of “accredited investor.” The issue is especially relevant to the committee as Regulation D is widely used by smaller businesses to raise funds.

At its December 17, 2014 meeting, the committee echoed many of the sentiments of the Investor Advisory Committee. The committee emphasized that wealth and investor sophistication do not always correlate, deliberated over whether thresholds should be raised for inflation, and considered whether retirement assets should be excluded from the calculation of net worth.

On March 9, 2015, the committee formally submitted the following recommendations to the SEC regarding the definition of “accredited investor”:

- to adopt a “sophistication test, regardless of income or net worth;”
- to take into account the effects of inflation on the income and net worth thresholds;
- to focus on enforcement and investor education efforts; and

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- to urge the SEC to continue gathering data on the topic.²⁵

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²⁵ Recommendations Regarding the Accredited Investor Definition, U.S. SECURITIES AND EXCHANGE COMMISSION (March 9, 2015), <https://www.sec.gov/info/smallbus/acsec/acsec-accredited-investor-definition-recommendation-030415.pdf>.