

The Legal Intelligencer

Expected Developments in Securities Laws in 2013

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The final quarter of 2012 and the early weeks of 2013 have already brought about many changes at the Securities and Exchange Commission. On December 14, 2012, Mary L. Schapiro stepped down from her position as chairman of the SEC and President Obama designated Elisse Walter to be Schapiro's interim replacement. As recent as January 24, Obama named Mary Jo White to assume the role of SEC chairman, subject to confirmation by the U.S. Senate. In the interim, Walter designated Lona Nallengara as acting director of the Division of Corporation Finance to replace Meredith B. Cross, who departed her position in December 2012; Walter also named John Ramsay as acting director of the Division of Trading and Markets to replace Robert W. Cook. On January 7, the SEC announced that Geoffrey F. Aronow would begin his role as the agency's general counsel later in the month to replace Mark D. Cahn. Finally, on January 9, Robert S. Khuzami announced his upcoming departure from the position of director of enforcement at the SEC.

While we cannot confirm how these changes will affect the practice of securities law, we do believe that some securities law developments will see the light in the coming year. First, amended listing standards from securities exchanges, mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) and recently approved by the SEC, are due to take effect later this year. Second, the SEC will most likely be engaging in rulemaking pursuant to Dodd-Frank. Finally, new developments concerning the Jumpstart Our Business Startups Act (JOBS Act) have been taking place and are expected to continue. This article briefly summarizes these developments.

SEC Approves Amended Listing Standards

On June 20, 2012, the SEC implemented Section 952 of Dodd-Frank by adopting Rule 10C-1 under the Securities Exchange Act of 1934, as amended. New Rule 10C-1 directs each national securities exchange to change its listing standards to require listed companies to comply with the rule's requirements regarding, among other matters, independence of compensation committees and compensation advisers. In response, the New York Stock Exchange and Nasdaq proposed rule amendments, and the SEC approved the amended rules on January 11.

The newly approved listing standards respond to two main areas addressed in Rule 10C-1. The first area deals with the independence of members of compensation committees. Rule 10C-1 requires that each member of a compensation committee be a member of the board of directors and be independent. The determination of whether a compensation committee member is independent must be based on, among other factors, consideration of the source of committee member's compensation and consideration of whether compensation committee members are affiliated with the company. The second area addressed in Rule 10C-1 concerns the authority of compensation committees to obtain advice from compensation advisers, as well as the independence of those advisers. Compensation committees must have the authority to appoint, pay and oversee compensation advisers, but only after considering certain factors pertaining to the compensation advisers' independence. The effective date for the new listing standards relating to the independence of members of compensation committees is the earlier of a listed company's first annual meeting after January 15, 2014, or October 31, 2014. July 1, 2013, is the effective date for the new listing standards relating to the responsibility of compensation committees to consider independence factors before selecting or obtaining advice from compensation advisers.

Dodd-Frank Provisions to be Implemented in Rulemaking

A number of securities and corporate governance items under Dodd-Frank still require SEC rulemaking prior to implementation. These items include: (1) pay for performance disclosure, (2) clawback requirements and (3) hedging restrictions. Because the SEC has not adopted rules related to these topics, they will not apply to the 2013 proxy season. However, we will likely see SEC rulemaking in 2013. In a speech before the Investor Advisory Committee on January 18, Walter stated that the SEC's goal of finishing the implementation of Dodd-Frank as well as the JOBS Act "will be at the top of the list" on the SEC's agenda.

Section 953(a) of Dodd-Frank directs the SEC to adopt rules that require companies to disclose in their annual proxy statements information regarding pay versus performance. This information must provide details with regard to an executive's compensation in relation to the financial performance of the company. The SEC must amend, pursuant to Section 953(b) of Dodd-Frank, Item 402 of Regulation S-K to require disclosure from companies about internal pay equity. This information must compare the annual compensation of the company's chief executive officer to the median compensation of the company's other employees. Section 954 of Dodd-Frank mandates that the SEC adopt rules directing national securities exchanges to change their listing standards to require clawbacks of overpaid performance-based executive compensation in the event the company is required to restate its financial statements. Specifically, listed companies must adopt policies that provide that, in the event that the company is required to prepare an accounting restatement due to the material noncompliance of the company with any financial reporting requirement under the securities laws, the company will recover, from any current or former executive officer who received incentive-based compensation, the excess of what would have been paid to the executive officer under the accounting restatement. The company must make such a recovery from executives who were paid during the three-year period preceding the date on which the company is required to prepare the accounting restatement. Additionally under Section 954 of Dodd-Frank, listed companies will be required to adopt policies that provide for disclosure of the companies' incentive-based compensation policies. Also, the SEC must

promulgate new rules under Section 955 of the Dodd-Frank Act to require companies to indicate in their annual proxy statements whether employees or directors (or any designees thereof) are allowed to buy financial instruments to hedge equity securities that the employee or director holds and that were issued by the company. Although we have been waiting some time for rules in these areas, there may be a chance we will see them in 2013.

Crowdfunding: New Form from FINRA

Title III of the JOBS Act contains provisions relating to crowdfunding. Crowdfunding, as that term is used in Title III, is a method of offering and selling up to \$1 million in securities without registration under the Securities Act of 1933, as amended. Crowdfunding, however, requires that individual investments do not exceed certain thresholds and the issuer of the securities satisfies other conditions. One of these conditions requires that issuers use the services of an intermediary for their crowdfunding activities that is either a broker registered with the SEC or a "funding portal" registered with the SEC. A funding portal must also become a member of a national securities association. As of today, the Financial Industry Regulatory Authority (FINRA) is the only national securities association. Accordingly, FINRA has recently taken steps toward developing rules about crowdfunding. In the meantime, the SEC has made it clear that crowdfunding is not yet permitted.

Early after the passage of the JOBS Act, FINRA raised its concerns about advancing capital-raising objectives of the JOBS Act while ensuring investor protection. FINRA solicited comments regarding rules it should adopt for funding portals and on the application of existing rules to broker-dealers engaging in crowdfunding activities.

On January 10, FINRA adopted a form that potential crowdfunding portals may use to provide information about their proposed crowdfunding businesses. The form, named the interim form for funding portals, may be submitted voluntarily. FINRA will treat any information provided on the form as confidential, and FINRA members and non-members may file the form. FINRA has also stated that entities, when they apply for FINRA membership to operate as funding portals, will not be bound by responses they provided on the interim form for funding portals. Rather, FINRA will use information from the forms to formulate rules applicable to crowdfunding portals.

Before crowdfunding portals may become FINRA members, the SEC must adopt funding portal rules and must approve FINRA's funding portal rules. FINRA and the SEC are therefore in ongoing discussions about the rules that will apply to funding portals. After FINRA and the SEC promulgate these funding portal rules, FINRA will issue a final funding portal application that will be required in order for a funding portal to become a FINRA member.

SEC's Proposed Rule about General Solicitation

On August 29, 2012, the SEC proposed rules pursuant to the JOBS Act to eliminate the current prohibition against general solicitation and general advertising in certain securities offerings. These proposed rules focus on conditions under which an issuer may engage in a general

solicitation and what steps are reasonably necessary to determine whether a purchaser is an accredited investor. Since August 2012, and continuing into January 2013, the SEC has been receiving comments and holding meetings regarding these proposed rules. While there are some difficult issues to consider, Walter, in recent remarks to the Investor Advisory Committee, acknowledged both the value of comments that the SEC has received, regarding the lifting of the restriction on general solicitation, as well as the importance of the SEC completing the implementation of the JOBS Act. Thus, many market participants are intently awaiting and expecting a final rule on this topic this year.

Upcoming Change

Dodd-Frank and the JOBS Act have and will continue to change the way companies raise capital and how investors may participate in the process. While many Dodd-Frank provisions have been implemented and some rulemaking progress has been made under the JOBS Act, there is more to be done, which can be expected in 2013, regardless of the change in leadership at the SEC.

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