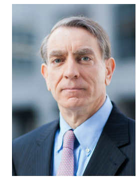
Securities Law and Corporate Governance Developments: A Look Back at 2015 and a Preview of 2016



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Related Practice Areas
- Corporate

Initiatives by Congress, the Securities and Exchange Commission (SEC), activist shareholders, and federal and state courts from 2015 will reshape public company disclosure and policies, and offer new avenues for private companies to raise capital in 2016. The SEC acted on a number of executive compensation-related rule-making requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), proposing regulations on hedging disclosure, pay-vs-performance disclosure and clawback rules, and adopting final regulations implementing CEO pay ratio disclosure. The SEC also adopted final regulations to implement capital raising under Regulation A+ and enable equity-based crowdfunding, as required by the Jumpstart Our Business Startups Act of 2012 (JOBS Act). Perhaps the most talked about issue among public company issuers during the 2015 proxy season was proxy access, and in late 2015, the SEC also provided guidance for public issuers on that topic. The following summary provides a brief description of the most important initiatives in securities law and corporate governance during 2015, and provides links to the related Cozen O'Connor Client Alerts.

SEC Executive Compensation Initiatives under Dodd-Frank

Dodd-Frank, broad legislation enacted in 2010 in response to the financial crisis, includes a number of provisions related to executive compensation policies and disclosure for public companies, many of which required SEC action for implementation. In 2015, the SEC proposed or finalized a number of important rules and regulations implementing aspects of Dodd-Frank.

Hedging

In February, the SEC proposed for comment new rules mandating disclosure by public company issuers regarding hedging policies applicable to directors, officers and employees. As proposed, the rules would require public companies to disclose whether directors, officers and other employees are permitted by corporate policy to hedge any decrease in the market value of the equity securities that are granted to them as compensation. Although the comment period for the proposed regulations closed in April, the SEC has not yet taken additional action to adopt final regulations. Click here to read our February 11 Alert "SEC Proposes Rules for Hedging Disclosure; Staff to Review Rule 14a-8(i)(9)" for more details.

Pay vs. Performance

At the end of April, the SEC proposed "pay versus performance" regulations, as required by Dodd-Frank. The proposed rule would require public companies to disclose the relationship between executive compensation and financial performance. More specifically, as proposed, the rule would mandate additional disclosure by public company issuers showing (a) the relationship between executive compensation paid to the company's named executive officers (NEOs) and the company's cumulative total shareholder return (TSR) and (b) the relationship between the company's TSR and the TSR of a peer group chosen by the issuer. The comment period on the proposed rules closed in July, and the SEC has not yet implemented any new disclosure rules. For more on this proposed rule, read our May 13 Alert, "SEC Proposes 'Pay Versus Performance' Rules as Required by Dodd-Frank"

Clawback Policy

The SEC proposed rules in July that would require national securities exchanges (such as NYSE and NASDAQ) to adopt new listing rules requiring issuers with publicly traded securities to implement and disclose a compensation clawback policy for executive officers. The clawback policy required by Dodd-Frank would apply to a broader class of executives and more types of incentive-based compensation than under the clawback provisions (Section 304) of The Sarbanes-Oxley Act of 2002 (SOX). The Dodd-Frank clawback requirements, once implemented by the SEC and the exchanges, would be mandatory and would apply regardless of the fault of the executive officer. The comment period for the proposed clawback regulations closed in September, and the SEC has not yet taken any further action. Read more about this in our July 8 Alert "SEC Proposes Clawback Rules for Listed Companies."

CEO Pay Ratio

In August, the SEC adopted final CEO pay ratio rules, which became effective on October 19, 2015. The CEO pay ratio rules require public companies to disclose in proxy statements the ratio of the annual total compensation of the CEO to the median total compensation of all employees. The CEO pay ratio will first be required to be disclosed for calendar year issuers in proxy statements for annual meetings held in 2018 (which would include compensation information for 2017). Here is a link to our Client Alert with additional details. Public companies with complex operations and employee bases should begin now to analyze the methodology they will use to calculate this ratio.

Activist Shareholder Initiatives

Institutional shareholders at public companies remained active in 2015, and discussions about proxy access dominated the 2015 proxy season. The New York City Comptroller jump-started the proxy access initiative by launching a Boardroom Accountability Project in the fall of 2014, sending proxy access shareholder proposals to 75 public companies. The SEC became involved by first granting, and then rescinding, no-action relief to a public company issuer that wanted to exclude a shareholder proxy access proposal from its proxy statement under SEC Rule 14a-8(i)(9), because it was "directly conflicting" with a similar management proxy access proposal. In an unexpected announcement in late January 2015, the SEC then indicated that it would not consider any no-action requests during the 2015 proxy season under Rule 14a-8(i)(9), as the SEC staff considered what it meant for proposals to "directly conflict."

During the 2015 proxy season, with more than 100 shareholder proxy access proposals submitted, public companies responded in a variety of ways. Some boards of directors, including GE and Prudential, voluntarily adopted proxy access bylaws, other issuers supported a shareholder proxy access proposal, and still others submitted both a shareholder and a management proxy access proposal to a vote of shareholders. As of mid-2015, it was estimated that as many as 60 public companies had adopted some form of proxy access bylaw. In late October, as discussed in our Client Alert, the SEC issued a Staff Legal Bulletin providing guidance on conflicting shareholder proposals under Rule 14a-8(i)(9) and how the SEC will approach future no-action requests. In that alert, the SEC also provided guidance on the "ordinary business exception" for excluding shareholder proposals under Rule 14a-8(i)(7), responding to a Third Circuit Court of Appeals decision in *Trinity Wall Street v. Wal-Mart Stores, Inc*.

New Capital Raising Avenues: Regulation A+ and Crowdfunding

In March, the SEC adopted widespread amendments to Regulation A under the Securities Act of 1933, a simplified public offering exemption that was little utilized prior to these amendments. New "Regulation A+," as it is called, permits issuers to offer up to $20 million in any 12-month period in a Tier 1 Regulation A+ offering and up to $50 million in any 12-month period in a Tier 2 offering. Since Regulation A+ was implemented in late June 2015, more than 25 offering statements have been filed with the SEC. Here is more information on Regulation A+ from our April 2 Alert, SEC Adopts Amendments to Regulation A to Facilitate Small Issuer Access to Capital.

The public was probably most interested in the SEC's adoption of final rules to implement securities based crowdfunding, as required by Title III of the JOBS Act, in late October. Regulation Crowdfunding provides a new exemption from securities law registration for up to $1 million of securities offered and sold in a crowdfunded offering in any 12-month period. The new crowdfunding regulations become effective May 16, 2016 (although certain forms will be effective January 29, 2016). If you would like more information about the SEC's new crowdfunding rules, click here for our Client Alert.

Looking Ahead to 2016

Looking ahead to 2016, what are the likely topics of conversation that will be discussed in board rooms and C-suites? Early in January, the New York City Comptroller announced expansion of its 2015 Boardroom Accountability Project by filing 72 new shareholder proxy access proposals, including proposals submitted to 36 companies that received proposals in 2015 but did not enact a proxy access bylaw. With this new initiative, directors and management will continue to discuss proxy access, and how to work with activist shareholders. Other governance topics that are likely to be discussed are board composition, including director overboarding (a director sitting on too many boards), director expertise and board refreshment, and political spending disclosure. Proxy advisory firms ISS and Glass Lewis have announced a new director overboarding policy that will be effective in 2017, recognizing that directors need "sufficient time and energy" to be effective shareholder representatives. A related board composition topic among directors is the question of board expertise. As we continue to transition to a global digital economy, boards are seeking to add international experience, technical knowhow and cybersecurity expertise. Nominating & Corporate Governance Committees may experience pressure to add new board members or replace existing board members who are retiring or stepping down with younger board members with digital and technical expertise. Directors are also likely to continue to discuss strategy and risk, particularly cybersecurity risk, and board expertise will be relevant to that discussion. Boards are seeking to effectively monitor and manage risk, consistent with the corporation's relative level of risk tolerance.

Public company disclosure of political spending also will likely continue to be debated, despite the language in the 2016 compromise budget passed by Congress that prohibits the SEC from spending any of its budget to finalize a rule that would require public companies to disclose political spending. Since the Supreme Court's 2011 decision in *Citizens United v. Federal Election Commission*, many commentators have called for the SEC to adopt a rule that would require public companies to disclose political spending annually, and many public companies now voluntarily publish this information. Commentators seeking such disclosure argue that disclosure of the use of corporate resources to promote political objectives should be required to promote corporate governance visibility and transparency. Although adopting a rule to require this disclosure is prohibited by the budget deal, many commentators suggest that the SEC could begin to work on a rule during 2016, or at least commence discussions among interested parties regarding how such a rule could work.

To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact Ellen Canan Grady at (215) 665-5583 or egrady@cozen.com.