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Quarterly Survey of SEC Rulemaking and Major Court Decisions (October 1, 2023 – December 31, 2023)

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This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from October 1, 2023 through December 31, 2023.

This quarter, the SEC proposed one new rule and approved eight final rules. In relevant part, the SEC's latest round of rulemaking largely targets reforms to the 1934 Act to increase regulatory oversight and promote market fairness for all participants. The most significant rule affects investors' beneficial ownership reporting obligations.

Final Rules

Modernization of Beneficial Ownership Reporting

On October 10, 2023, the SEC adopted amendments to Section 13(d) and Section 13(g) of the 1934 Act, most notably by shortening the filing deadlines for Schedule 13D and Schedule 13G filings. In addition to the amendments, the SEC also provided new guidance for cash-settled derivative securities, including slight rule changes that clarified the legal standard for determining the existence of an investing "group" under Sections 13(d) and 13(g).

Background

Under Sections 13(d) and 13(g) of the 1934 Act, any person or group of persons owning or acquiring more than 5% of any covered class of equity securities registered under the 1934 Act is required to publicly file with the SEC either a Schedule 13D or Schedule 13G, depending on the nature of its ownership and the circumstances of its acquisition of the securities. Generally speak-

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ing, an investor that intends to control or change the control of a company is obligated to file a Schedule 13D and passive investors that do not intend to control or change the control of a company are able to file a Schedule 13G, which as fewer disclosure requirements.

The filing deadlines for Schedule 13D and Schedule 13G have not been changed since the initial adoption of the reporting requirements almost 50 years ago. The SEC noted in the October 2023 adopting release that due to the vast technological advancements since the rules were first made the original filing deadlines have become antiquated. Supporters of shortening the filing deadlines pointed to these technological advancements mentioned by the SEC as reasoning for shortening the filing deadlines, but critics expressed concern that premature disclosures of beneficial ownership may limit the gains that can be realized by activist investors and other investors who see value opportunities.

When first proposed in February 2022, the SEC initially contemplated even shorter filing deadlines for Schedule 13D and Schedule 13G than those included in the final amendments, described in detail below, along with stringent new rules that would govern group activity and establish when certain holders of cash-settled derivatives may be deemed beneficial owners for Schedule 13D purposes. However, the final rules adopted by the SEC pulled back in a number of ways from the initial proposals in order to balance the interests of those investors that will need to comply with these new final rules.

Filing Deadlines for Schedule 13D

Prior to adoption of this final rule, the deadline to file an initial Schedule 13D was 10 calendar days after crossing the 5% beneficial ownership threshold. Now, for initial Schedule 13D filings, the final rules accelerate the deadline from 10 calendar days to five business days after acquiring more than the 5% beneficial ownership threshold or losing eligibility to file on Schedule 13G. In addition, the filing deadline for any required amendments to a Schedule 13D is now two business days after the date on which a "material" change occurs instead of "promptly" filing after the date on which a "material" change occurs. Schedule 13D filers have historically taken differing approaches in interpreting the meaning of the term "promptly" with regards to the filing of Schedule 13D amendments. The final rules clarify the understanding of this "prompt" requirement by setting a hard deadline for filing a Schedule 13D amendment within two business days after the date on which a material change occurs.

Filing Deadlines for Schedule 13G

Three categories of investors are eligible to file the less onerous

Schedule 13G: Qualified Institutional Investors ("QIIs"), Exempt Investors and Passive Investors. The recently adopted final rules amended the filing Schedule 13G filing deadlines of QIIs, Exempt Investors and Passive Investors differently, so it important that investors properly determine whether they qualify as a QII, Exempt Investor or Passive Investor.

A person will qualify as a QII if the investor (i) is acquiring the securities in the ordinary course of business and not with the purpose or effect of changing or influencing the control of the company, (ii) is an institutional investor, such as a broker-dealer, a bank, an insurance company, a qualified employee benefit plan or pension fund or a registered investment company or investment adviser, and (iii) promptly notifies any other person or group on whose behalf it holds securities exceeding 5% of the class of equity securities of any acquisition or transaction on behalf of that other person that might be reportable by that person under Section 13(d). A person will qualify as an Exempt Investor if such person holds more than 5% of an equity security that is not subject to, or whose acquisition is exempt from, Section 13(d). A person will qualify as a Passive Investor if such person owns more than 5%, but less than 20%, of a company's registered equity securities and can certify that such equity securities were not acquired or held for the purpose or effect of changing or influencing the control of the company issuing such securities and were not acquired in connection with, or as a participant in, any transaction meant to have such purpose or effect.

Filing Deadlines for Initial Schedule 13G

Prior to the adoption of these final rules, QIIs and Exempt Investors were required to file an initial Schedule 13G within 45 calendar days after the end of the calendar year in which their beneficial ownership exceeded 5% of a class of equity securities of an issuer registered under the 1934 Act. The final rules shift this initial reporting requirement from year-end to quarter-end. QIIs and Exempt Investors will now have to file an initial Schedule 13G within 45 calendar days after the end of the calendar quarter in which their beneficial ownership exceeded 5% of a class of equity securities of an issuer registered under the 1934 Act. Further, under the prior Schedule 13G filing regime a QII that acquired more than 10% of a company's registered equity securities at any time was required to file an initial Schedule 13G within 10 calendar days after the end of the month in which their beneficial ownership exceeded 10%. Now, pursuant to the final rules, a QII will be required to file that initial Schedule 13G within five business days after the end of the month in which their beneficial ownership exceeds 10%.

Prior to the adoption of these final rules, Passive Investors were required to file an initial Schedule 13G within 10 calendar days after acquiring beneficial ownership of more than 5% of a class of equity securities of an issuer registered under the 1934 Act. Now, pursuant to the final rules, Passive Investors will be required to file an initial Schedule 13G within five business days after acquiring beneficial ownership of more than 5% of a class of equity securities of an issuer registered under the 1934 Act.

Filing Deadlines for Amendments to Schedule 13G

Prior to the adoption of these final rules, QIIs, Exempt Investors and Passive Investors were required to file an amendment to Schedule 13G within 45 calendar days after the calendar year-end following any change in the facts set forth in their previous Schedule 13G filing. Now, the final rules require that QIIs, Exempt Investors and Passive Investors file an amendment to Schedule 13G within 45 calendar days after the calendar quarter following any "material" change in the facts set forth in their previous Schedule 13G filing. A "material" change that will trigger the requirement to file an amendment to Schedule 13G will be an acquisition or disposition of beneficial ownership of securities in an amount equal to one percent or more of the class of equity securities, which is the same standard for Schedule 13D as set forth in Rule 13d-2(a).

There are also additional changes to the filing deadlines that apply specifically to QIIs and Passive Investors in certain situations. Prior to the adoption of these final rules, QIIs were also required to file an amendment to Schedule 13G within 10 calendar days after the end of month in which their beneficial ownership exceeded 10% of a class of equity securities of an issuer registered under the 1934 Act or there was, as of the month-end, a 5% increase or decrease in their beneficial ownership. This filing deadline has now been shortened from 10 calendar days after month-end to five business days after month-end.

Additionally, prior to the adoption of these final rules, Passive Investors were also required to file an amendment to Schedule 13G "promptly" after their beneficial ownership exceeded 10% of a company's registered equity securities or there was a 5% increase or decrease in their beneficial ownership. This filing deadline has now been changed from "promptly" to within two business days after acquiring beneficial ownership of more than 10% of a class of equity securities of an issuer registered under the 1934 Act or there was a 5% increase or decrease in their beneficial ownership.

Guidance and Clarifications Regarding Cash-Settled Derivative Securities and Group Formation

In a departure from the proposed amendments, the SEC did not adopt proposed Rule 13d-3(e), which would have deemed certain holders of cash-settled derivative securities to be beneficial owners of that reference covered class. Instead, the SEC provided guidance under current Rule 13d-3 to discuss that persons using these types of derivative securities may already be subject to regulation as if they are beneficial owners. The guidance includes an amendment to Item 6 of Schedule 13D, codified as Rule 13d-101, which clarifies that a filer is required to disclose its interests in all security-based swaps or any other derivative securities that use the issuer's class of equity security registered under the 1934 Act as a reference security. The SEC stated in the adopting release that this amendment is intended to eliminate any ambiguity regarding the scope of the disclosure obligations of Item 6 of Schedule 13D as to derivative securities, including with respect to any derivative not originating with, or offered or sold by, the issuer, such as a cash-settled option or security-based swap.

The SEC also provided guidance under the final rules as to what marks the formation of an investing "group" under Sections 13(d)(3) and 13(g)(3) of the 1934 Act. Currently, a "group" is formed under the 1934 Act for investment purposes when two or more persons act as a group for purposes of acquiring, holding or disposing of securities. Rule 13d-5(b)(1) further states that a "group" is a formed when two or more persons formally agree to act together for the aforementioned purposes. The proposed rules provided for a codification of the SEC's view that the determination of a "group" is ultimately fact-dependent and does not require an express agreement under Rule 13d-5(b). Though the SEC declined to adopt the codification of this understanding in the adopting release, it did issue guidance reiterating that the relevant legal standard for the determination of an investing group remains rooted in the context of the situation and does not require an express agreement despite the language in Rule 13d-5(b)(1).

Other Amendments to Schedules 13D and 13G

In light of the shortened filing deadlines for Schedules 13D and 13G described above, the final rules also amend Regulation S-T to extend the EDGAR filing "cut-off" times for Schedule 13D and Schedule 13G filings from 5:30 pm Eastern Time on any given business day to 10:00 pm Eastern Time. In addition, the SEC also adopted amendments that will require Schedules 13D and 13G to be filed using XML-based language.

Effective Dates

Starting on February 5, 2024, Schedule 13D filers will be required to comply with the adopted amendments to Schedule 13D. Starting on September 30, 2024, Schedule 13G filers will be required to comply with the adopted amendments to Schedule 13G. Finally, starting on December 18, 2024, both Schedule 13D filers and Schedule 13G filers will be required to comply with the XML structured data presentation requirements.

Reporting of Securities Loans

On October 13, 2023, the SEC adopted a new rule codified under 17 C.F.R. § 240.10c-1a governing the reporting of securities loans under the 1934 Act known as Rule 10c-1a. The final rule requires reporting of any loan of a "reportable security" made by a "covered person," each as defined in the new rule. Information regarding securities loans must be reported to a registered national securities association, effectively meaning the Financial Industry Regulatory Authority ("FINRA"), who will then make the furnished information available to the public.

Rule 10c-1a defines a "covered person" as (i) any person that agreed to a covered securities loan on behalf of an intermediary other than a clearing agency when providing only functions of a central counterparty pursuant to Rule 17Ad-22(a)(6) or a central securities depository pursuant to Rule 17Ad-22(a)(3); (ii) any person that agrees to a covered securities loan as a lender when an intermediary is not used unless (iii) applies; or (iii) a broker or dealer when borrowing its customers' fully paid or excess margin securities pursuant to Rule 15c3-3(b)(3) (in which case, the broker-dealer, rather than the customer loaning the securities, will bear the reporting obligation). The final rule also replaces the proposed rule's use of "security" as defined in Section 3(a)(10) of the 1934 Act with the narrower term "reportable security" defined as any security or class of an issuer's securities for which a cash market transaction would be reportable under the Consolidated Audit Trail National Market System Plan, FINRA's Trade Reporting and Compliance Engine ("TRACE"), or the Municipal Securities Rulemaking Board's Real-Time Transaction Reporting System. When a covered person makes a loan of a reportable security to another person, such transaction is a "covered securities loan" under Rule 10c-1a. A covered securities loan explicitly excludes positions at a clearing agency that result from central counterparty services or central securities depository services, such as the novation of a securities loan, or a broker-dealer's use of margin securities as defined in Rule 15c3-3(a)(4) (unless the broker-dealer lends the margin securities to another person).

Rule 10c-1a will impose certain additional operational and compliance obligations on covered persons, including many broker-dealers, custodian banks acting as agent lenders, investment advisers and funds, and certain clearing agencies, all of which will now need to report transactions of reportable securities loans to FINRA, including specific data requirements set forth in the new rule. These data elements can be categorized into three general buckets. In the first category, loan data elements must be reported that include (i) the identifying information of the issuer of the security subject to the loan (e.g., issuer name, CUSIP, etc.), (ii) information related to the loan itself such as the date and time and the amount of securities loaned, (iii) information related to the collateral for the loan, and (iv) any loan rebate or fee information, including the lending rate. In the second bucket, loan modifications to the specific material terms of the loan must be provided to FINRA by the end of the day on which the modification occurred. Lastly, certain confidential data elements of a securities loan must be provided to FINRA by the end of the day on which a covered securities loan is consummated, with such information being kept confidential by FINRA, subject to applicable law. Such confidential information includes (i) specific information concerning each party to the loan, (ii) in transactions where a broker-dealer is making a loan to a customer, whether the loan is from the broker-dealer's inventory of securities, and (iii) whether the securities loan is being used to close out a "failure to deliver" subject to Rule 204 of Regulation SHO or outside Rule 204, as applicable.

Rule 10c-1a is intended to provide an additional tool for the SEC to surveil the marketplace and to provide the investing public with increased transparency of the securities lending market. The final rule removed certain proposed elements that certain commenters argued were exceptionally burdensome, including the key change to remove the requirement to provide daily information regarding the total amount of securities that a person has "on loan" and "available to lend." Additional changes from the proposed rules included those to the timing of reports, such as making FINRA's obligation to report a transaction or modification by end-of-day instead of within 15 minutes of the effectuation of the loan or modification.

Rule 10c-1a became effective January 2, 2024. FINRA will be required to propose rules to implement Rule 10c-1a within four months of January 2, 2024, and in turn such rules must go into effect no later than January 2, 2025. Covered persons must begin furnishing required information under Rule 10c-1a to FINRA on January 5, 2026. Certain information furnished to FINRA under Rule 10c-1a will be made publicly available by FINRA in accordance with the final rule within 90 days thereafter.

Short Sale Disclosure

On October 13, 2023, the SEC adopted new Rule 13f-2 and related Form SHO which will require certain institutional investment managers to disclose short-sale-related information to the SEC. Rule 13f-2 seeks to address Section 929X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") to provide more transparency to the process of short selling.

Rule 13f-2 will apply to all institutional investment managers. Rule 13f-2 uses the same definition of institutional investment manager that is used for purposes of Form 13F, which extends to investment advisers that are not registered with the SEC. Rule 13f-2 will apply to institutional investment managers even if their holdings do not exceed the $100 million reporting threshold set forth in Rule 13f-1. As defined under the 1934 Act, institutional investment managers mean any person, other than a natural person, investing in or buying and selling securities for its own account and any person exercising investment discretion with respect to the account of any other person. Since Rule 13f-2 is not subject to the $100 million threshold described above, this new rule will cover a new class of institutional investment managers that have not traditionally been required to report their positions with the SEC.

Rule 13f-2 will require institutional investment managers to file a Form SHO if it exceeds one of the thresholds described below during a calendar month. The thresholds depend on whether the short position relates to an equity security of a reporting company or non-reporting company. For equity securities of a reporting company, Rule 13f-2 will require an institutional investment manager to file Form SHO to report each "gross short position" over which it and any person under such institutional investment manager's control has investment discretion that, collectively, has a monthly average gross short position at the close of regular trading hours at the end of a calendar month in the equity security (i) of at least $10 million or, (ii) at least 2.5% of the shares outstanding.

However, for short positions in equity securities of a non-reporting company, disclosure of such short position is required for each gross short position with a value that is equal to or exceeds $500,000 at the close of regular trading hours on any settlement date during the calendar month. Rule 13f-2 defines a gross short position as the number of shares of the equity security that are held short as a result of short sales, without inclusion of any offsetting economic positions such as shares of the equity security or derivatives of such equity security. Institutional investment managers will need to determine on a monthly basis whether they need to file a Form SHO.

If an institutional investment manager determines that it needs to file a Form SHO, such Form SHO will need to be filed with the SEC via EDGAR within 14 calendar days following the end of the calendar month its necessity is ascertained. Institutional investment managers will need to disclose on Form SHO certain information such as their end of month gross short position in the equity security at the close of regular trading hours on the last settlement date of the calendar month and, for each individual settlement date during the calendar month, the institutional investment manager's net activity in the equity security, which includes activity in derivatives such as options.

Forms SHO filed with the SEC will not be made publicly available. However, the SEC will publish through EDGAR, on a slightly delayed basis (which is expected to be within one month after the end of the reporting calendar month), certain aggregated short sale related information regarding each equity security that is reported by institutional investment managers through Form SHO filings. Such information will include each equity security's aggregate gross short position as of the calendar month's last settlement date, the aggregate gross short position's dollar value and the net activity of the equity security for each individual settlement date during the calendar month.

The SEC noted that the delay in reporting such aggregated information mentioned above is intended to reduce the risk of imitative trading activity by market participants and to protect institutional investment managers' proprietary trading activities. However, it is unclear at this time whether a person can successfully submit a FOIA request to obtain an as-filed copy of a Form SHO.

Rule 13f-2 and Form SHO became effective January 2, 2024. Institutional investment managers will be required to comply with Rule 13f-2 and Form SHO 12 months after the effective date (January 2, 2025), with public reporting of the aggregated information by the SEC to follow three months later.

Rules Relating to Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities

On November 2, 2023, the SEC adopted new Regulation SE of the 1934 Act and a set of rules promulgated thereunder to create a new regulatory framework for the registration and regulation of security-based swaps ("SBS") and related security-based swap execution facilities ("SBSEFs"). The final rules serve to implement Section 765 of the Dodd-Frank Act to mitigate conflicts of interest at SBSEFs and national securities exchanges that list SBS. Regulation SE will substantially affect end users of SBS and other financial entities and trading houses that facilitate SBS transactions between multiple counterparties as they will have to register as SBSEFs under the new regulation. The final rules should be familiar in substance to effected parties, as they very closely mirror those already in place for entities operating with the Commodity Future Trading Commission's ("CFTC") regulated swaps market. The SEC's final rules prioritize harmonization between the CFTC's regulatory regime and that of Regulation SE in consideration of the fact that impacted entities will now largely be required to register under both frameworks.

Rule 802 of Regulation SE defines the meaning of an SBSEF by cross-referencing the definition in Section 3(a)(77) of the 1934 Act which is "a trading system or platform in which multiple participants have the ability to execute or trade [SBS] by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that — (A) facilitates the execution of [SBS] between persons; and (B) is not a national securities exchange." Such entities that qualify as a SBSEF will be subject to registration pursuant to Rule 803 of Regulation SE by registration on new Form SBSEF to be filed with the SEC via EDGAR, or otherwise must register or qualify as a national securities exchange. Foreign SBS trading venues may seek an exemption pursuant to Rule 833(a) of Regulation SE from the requirement to register. Once filed, the SEC will have 180 days to approve or reject the prospective SBSEF's application by the form of an order granting registration. Entities whose applications are rejected by the SEC would have to revise and resubmit their Form SBSEF application in line with SEC's comments accompanying such rejection, thereby restarting the 180-day timeline. The SEC review of an SBSEF application will not be subject to public comment and is similar to that of the review procedures conducted by the CFTC, hopefully minimizing the burden imposed on applicants as the SEC expects them to be generally familiar with CFTC requirements.

As the new rules pertain to the execution and use of SBS itself, a number of rules established under Regulation SE establish requirements for trade executions, governance and reporting requirements. A registered SBSEF must, among other requirements, (i) monitor trading of SBS to prevent manipulation, price distortion, and delivery or settlement disruptions, (ii) make public information on price, trading volume, and other trading data on SBS transactions available on its website via a "Daily Market Data Report," (iii) maintain records of all activities in the facility for a period of five years, and (iv) establish and maintain systems providing for automated backup, risk analysis and emergency/disaster management. Additionally, regarding the listing of SBS products, Rules 804 and 805 set forth certain requirements for listing and submission of products for trading. These submission requirements are largely voluntary and involve self-certifications by SBSEFs of rules compliance, with the exception of Rule 804(a)(2), which requires SBSEFs to file notification of a new SBS product with the SEC at least 10 business days before the product's listing. SBSEFs will also submit their own rules and rule amendments through voluntary submission and self-certification under Rules 806 and 807, respectively, in a process closely modeling that of Section 40.5 of the CFTC's rules. Other new SBS rules established under Regulation SE include certain cross-border trading requirements under Rule 832 and Rule 833. Rule 832 explains that certain cross border trades are subject to the "trade execution requirement" established under Section 3C of the 1934 Act, which requires that counterparties to the transaction must execute it on either a national securities exchange or a registered or exempt SBSEF. Previously, no SBS were subject to the trade execution requirement. Rule 833 provides that the SEC may provide certain cross-border exemptions for foreign SBS trading venues, broadening the scope of "exempt SBSEFs" mentioned in the foregoing sentence.

The final rules relating to SBS execution and SBSEFs become effective on February 13, 2024. An entity that meets the SBSEF definition will be able to file a registration application once the rules become effective. Any entity that acts as an SBSEF but does not file a registration application by the date that is 180 days after the effective date will be in violation of the registration requirement unless it can rely on an exemption.

Prohibition Against Conflicts of Interest in Certain Securitizations

On November 27, 2023, the SEC adopted a rule under the 1933 Act to prohibit conflicts of interest in certain securitization transactions prescribed under the Dodd-Frank Act. New Rule 192 prohibits for a specified period of time a securitization participant from engaging, directly or indirectly, in any transaction that would involve or result in any material conflict of interest between the securitization participant and an investor in a relevant asset-backed security ("ABS"), subject to certain exceptions.

New Rule 192 applies to any underwriter, placement agent, initial purchaser or sponsor of an ABS. It also applies to any affiliate or subsidiary that acts in coordination with one of the aforementioned parties or that has access to, or receives information about, the ABS or asset pool underlying or referenced by the ABS prior to the first closing of the sale of the relevant ABS. Each of such parties previously mentioned are securitization participants. Rule 192 defines ABS to include any ABS within the meaning of Section 3 of the 1934 Act, as well as any synthetic ABS and hybrid cash and synthetic ABS.

Specifically, new Rule 192 prohibits a securitization participant from entering into a conflicted transaction for a period that begins on the date on which such person has reached an agreement to become a securitization participant with respect to an ABS and ends one year after the date of the first closing of the ABS's sale. For purposes of Rule 192, the term conflicted transaction is defined to include two main components. The first component is whether the transaction is (i) a short sale of the ABS, (ii) the purchase of a credit default swap or other credit derivative that entitles the securitization participant to receive payments upon the occurrence of specified credit events with respect to the ABS or (iii) the purchase or sale of any financial instrument (other than the relevant ABS) or entry into a transaction that is substantially the economic equivalent of a transaction described in points (i) and (ii) above, other than, for the avoidance of doubt, any transaction that only hedge general interest rates or currency exchange risk. The second component is related to materiality, such as whether there is a substantial likelihood a reasonable investor would consider the relevant transaction important to the investor's investment decision, including a decision whether to retain the ABS.

The following three activities are excluded from the prohibition set forth in Rule 192: (i) risk-mitigating hedging transactions designed to reduce specific identifiable risks to a securitization participant in connection with, and related to, positions, contracts or other holdings of the securitization participant; (ii) purchases or sales made pursuant to commitments of securitization participants to provide liquidity for the ABS; and (iii) purchases or sales made pursuant to bona fide market-making in the ABS, the underlying assets of the ABS or financial instruments that reference the ABS. In addition to these exclusions, Rule 192 also provides a safe harbor for certain foreign transactions. In any event, Rule 192 prohibits a securitization participant from engaging in a transaction or a series of related transactions that, although in compliance with certain exclusions, is part of a plan or scheme to evade the rule's prohibition.

Rule 192 will become effective on February 5, 2024 and compliance with Rule 192 will be required with respect to the first closing of any ABS sale that occurs on or after June 9, 2025.

Proposed Rules

SEC Proposes New Volume-Based Exchange Transaction Pricing for NMS Stocks

Marking the only proposed rule by the SEC in the fourth quarter of 2023, on October 18, 2023, the SEC proposed a new rule under the 1934 Act to prohibit national securities exchanges from offering volume-based transaction pricing in connection with the execution of agency or riskless principal orders in national market system ("NMS") stocks.

National securities exchanges (e.g., New York Stock Exchange, Nasdaq, etc.) that trade NMS stocks customarily maintain pricing schedules that set forth special transaction pricing for broker-dealer members that execute orders on their trading platform. Most exchanges have complex transaction pricing schedules that feature differentiated incentives for its members based on a particular member's trading volume. For example, these exchanges may offer its members lower fees or higher rebates as the number of shares the member executes on such exchange reaches certain volume-based tiers. The SEC noted that there are broad concerns about such volume-based transaction pricing generally because of the notion that it fosters anti-competitive practices and exacerbates potential conflicts of interests between members and their customers to the extent that members route their customers' order to a particular exchange in order to obtain volume-based discounts.

Thus, the SEC proposed new Rule 6b-1 under the 1934 Act to prohibit national securities exchanges from offering volume-based transaction pricing in connection with the execution of agency or riskless principal ("agency-related") orders in NMS stocks. The proposed rule defines "riskless principal" to mean a transaction in which, after having received an order to buy from a customer, the broker or dealer purchased the security from another person to offset a contemporaneous sale to such customer or, after having received an order to sell from a customer, the broker or dealer sold the security to another person to offset a contemporaneous purchase from such customer. The proposed prohibition would apply to all executions where a member is executing such an order for the purpose of filling a customer order and not trading for its own account. However, this prohibition would not apply to an exchange member's proprietary volume, which is when a member is trading solely for its own account and not in connection with filing a customer order.

For national securities exchanges that offer volume-based transaction pricing in connection with the execution of proprietary orders in NMS stocks for the account of a member, such exchanges would be required to (i) submit monthly filings to the SEC containing certain information regarding their volume-based transaction pricing tiers and the number of members that qualify for each tier and (ii) have anti-evasion measures, including rules requiring the adoption of written policies and procedures meant to detect and deter members from receiving volume-based transaction pricing in connection with the execution of agency-related orders in NMS stocks. Proposed Rule 6b-1 would not apply to option markets, although the SEC is soliciting comment regarding whether the proposed rules should be extended to such trading.

The comment period for the proposed rule closed on January 5, 2024.

On the Horizon

Accredited Investor Definition

On December 15, 2023, the SEC staff issued a report on the definition of an accredited investor. Section 413 of the Dodd-Frank Act requires the SEC to review the accredited investor definition as it relates to natural persons once every four years to determine whether the definition should be amended for the protection of investors, in the public interest, and in light of the economy.

"Accredited investor" is a term defined under Rule 501(a) of Regulation D. Persons who qualify as an accredited investor are able to invest in certain private securities offerings. Currently, to qualify as an accredited investor, a natural person must (i) have a net worth exceeding $1 million; (ii) have an annual income over $200,000 (or over $300,000 in joint income with that person's spouse or spousal equivalent) and has a reasonable expectation of reaching the same income level in the current year; or (iii) satisfy one of the other relevant criteria for natural persons under Rule 501(a) (separate qualification standards exist for entities).

The SEC staff report focused on changes in the composition of the accredited investor pool since the adoption of the accredited investor definition, but did not recommend changes to the definition. The SEC staff report did highlight previous recommendations such as indexing all financial thresholds in the definition for inflation on a go-forward basis, as recommended in its 2015 and 2019 reports, and in connection with the 2020 amendments, a solicitation for comment on whether the SEC should make a one-time inflation adjustment to the accredited investor financial thresholds.

The SEC staff report noted that estimates in 1983, one year after the exemption for public registration was created, only 1.8% of households in the United States met one of the three net worth or income thresholds to qualify as accredited investors under Regulation D. In 1989, this percentage increased to 3%. By the end of 2022, 18.5% of households in the United States qualified as accredited investors. The report attributed this increase to the fact that accredited investor thresholds have not been adjusted for inflation. The report further estimated that if accredited investor thresholds are not adjusted for inflation going forward, approximately 30% of households in the United States will qualify as accredited investors by 2032.

Since its adoption in 1982, the accredited investor definition has been substantively amended four times, with the last amendments in 2020. The SEC asked for public comment on the December 15, 2023 report. Given that the SEC also indicated in its Fall 2023 Regulatory Flexibility Agenda that the SEC is considering updates to Regulation D, the SEC may be gearing up to propose updates to the accredited investor definition.

Reg Flex Agenda

On December 6, 2023, the SEC released its Fall 2023 Regulatory Flexibility Agenda ("Reg Flex Agenda") identifying rules the agency expects to consider in the next 12 months that are likely to have a significant economic impact on a substantial number of small entities. As a federal agency, the SEC is required to publish a Reg Flex Agenda on a biannual basis. The publication of the Reg Flex Agenda does not preclude the SEC from considering or acting on any matter not included in the agenda. The Fall 2023 Reg Flex Agenda is quite a bit shorter than that published in the Spring.

The SEC anticipates finalizing three major rules that may be published in April 2024. The first rule, known as the "Climate Change Disclosure" rule, would require public companies to disclose information about material climate-related impacts on a company's strategy, business model, outlook and risks. The second rule on the horizon pertains to special purpose acquisition companies ("SPACs"). This potential final rule would impose specialized disclosure requirements by SPACs with respect to, among other things, compensation paid to SPAC sponsors, conflicts of interest, dilution and financial statements, and the fairness of these SPAC-driven business combination transactions. The third final rule outlined in the Reg Flex Agenda would narrow certain grounds under which companies may exclude shareholder proposals submitted under Rule 14a-8 from their proxy statements.

In addition, the SEC has indicated it may propose rules requiring human capital management disclosures, Regulation D and Form D improvements, revisions to the definition of securities "held of record" for the purposes of Section 12(g) of the 1934 Act, enhancements to required disclosures regarding diversity of board members and nominees, and lastly amendments to Rule 144.

Second Circuit Holds that Disgorgement Remedy Available to the SEC under 15 U.S.C.A. § 78u(d)(5) and (7) Is Subject to Equitable Limitations

On October 31, 2023, the United States Court of Appeals for the Second Circuit held that the disgorgement remedy available to the U.S. Securities and Exchange Commission (the "SEC") under 15 U.S.C.A. § 78u(d)(5) and (7) is subject to equitable limitations. The Second Circuit found that the District Court erred in authorizing disgorgement because it failed to determine whether defrauded investors had suffered pecuniary harm. Additionally, the Second Circuit held that the District Court erred in calculating its disgorgement award to Defendant-Appellant Aron Govil ("Govil") because the District Court failed to credit his surrendered securities in its determination of the amount of disgorgement. The Second Circuit remanded the case to the District Court to reconsider whether the investors suffered pecuniary harm, and if so, to credit the value of Govil's surrendered securities against the overall disgorgement award. Notably, following the Second Circuit's decision in this action, *SEC v. Govil*, there is a circuit split with the Fifth Circuit, which previously held that 15 U.S.C.A. § 78u(d)(7) authorized "disgorgement in a legal—not equitable—sense." *See Securities and Exchange Commission v. Hallam*, 42 F.4th 316, 338, Fed. Sec. L. Rep. (CCH) P 101429 (5th Cir. 2022).

Govil was the founder of Cemtrex, Inc. ("Cemtrex"), a public company with its common shares listed on NASDAQ. Between 2016 and 2017, Govil caused Cemtrex to engage in three fraudulent securities offerings. Govil made representations to Cemtrex investors that the proceeds of the offerings would be used to satisfy outstanding debts and for general corporation purposes.

However, Govil funneled more than $7 million of the proceeds into his personal accounts. In anticipation of an enforcement action by the SEC, Govil entered into a Consent Agreement with the SEC. Govil also reached a settlement with Cemtrex. As a condition of that settlement, Govil surrendered his securities in Cemtrex, valued at $5,566,720, and agreed to pay approximately $1.5 million pursuant to a secured promissory note. The SEC moved in District Court to authorize additional disgorgement against Govil. The District Court held that disgorgement was equitable, but that the value of the surrendered stock could not be counted toward the amount of disgorgement. The District Court ordered Govil to pay approximately $5.8 million in disgorgement—the amount requested by the SEC minus the value of the promissory note.

Two issues were raised on appeal before the Second Circuit. First, whether, given the facts of the case, disgorgement was authorized under 15 U.S.C.A. § 78u(d)(5) or § 78u(d)(7). Second, if disgorgement was authorized, whether the District Court erred in failing to credit Govil's surrendered securities in its disgorgement award.

The Second Circuit resolved the first question by holding that disgorgement was not authorized, because the disgorgement provisions of the Exchange Act require a showing that investors were harmed, and the District Court did not find that the SEC had made such a showing. The Second Circuit relied on a 2020 Supreme Court decision, *Liu v. Securities and Exchange Commission*, 140 S. Ct. 1936, 207 L. Ed. 2d 401, Fed. Sec. L. Rep. (CCH) P 100851 (2020), which provides that disgorgement under 15 U.S.C.A. § 78u(d)(5) is equitable relief, may not exceed a wrongdoer's net profits, and may only be awarded to victims. In the recent case, *United States Securities and Exchange Commission v. Ahmed*, 72 F.4th 379, Fed. Sec. L. Rep. (CCH) P 101626 (2d Cir. 2023), the Second Circuit applied *Liu*'s reasoning to an award of disgorgement pursuant to Section 78u(d)(7). Relying on *Liu* and *Ahmed*, the Second Circuit held in *SEC v. Govil* that the District Court abused its discretion by ordering disgorgement without a finding of pecuniary harm.

As to the second question, the Second Circuit opined that "forcing a defendant to pay disgorgement twice amounts to a penalty." The Second Circuit thus held that, if disgorgement is appropriate, then the value of the shares that Govil surrendered to Cemtrex, as well as the value of the promissory note, must be deducted from any award of disgorgement.

SEC v. Govil, case no. 22-1658, in the U.S. Court of Appeals for the Second Circuit.

Fifth Circuit Vacates SEC Stock Buyback Rule

On October 31, 2023, the United States Court of Appeals for the Fifth Circuit held the SEC had acted arbitrarily and capriciously in its rulemaking relating to a rule that required issuers to report quarterly day-to-day share repurchase data and to list the reason why the issuer repurchased the stock. Specifically, the Fifth Circuit found the SEC failed to adequately respond to comments during the public notice and comment period. Additionally, the Fifth Circuit stated that the SEC failed to conduct and consider a proper cost-benefit analysis of the rule. The Fifth Circuit granted the SEC thirty days to correct for these deficiencies. The SEC failed to do so. Thus, on December 19, 2023, the United States Court of Appeals for the Fifth Circuit vacated the SEC's rule.

The Chamber of Commerce of the United States, Longview Chamber of Commerce, and Texas Association of Business (“Petitioners”) petitioned the Fifth Circuit to review the SEC’s final rule, adopted on May 3, 2023, that required issuers to report day-to-day share repurchase data once a quarter and to disclose the reason why the issuer repurchased shares of its own stock. Petitioners argued that the rule violated the First Amendment by impermissibly compelling speech, and that the SEC acted arbitrarily in adopting the final rule without considering their comments or conducting a proper cost-benefit analysis. The Fifth Circuit rejected Petitioners’ First Amendment argument, but held that the rule was arbitrary and capricious because the SEC failed to respond to Petitioners’ comments and failed to conduct a proper cost-benefit analysis. The Fifth Circuit held, however, that there was a “serious possibility” that the SEC would be able to substantiate its decision if given a chance to do so. Accordingly, the Fifth Circuit remanded with direction to the SEC to correct the defects in the rule within 30 days.

On November 22, 2023, the SEC sought an extension of the 30-day deadline to correct the rule’s defects. The Fifth Circuit denied that request. Then, one day after the deadline expired, the SEC filed a letter stating that it was not able to correct the rule’s deficiencies within 30 days. Thus, on December 19, 2023, the Fifth Circuit vacated the rule as arbitrary and capricious, in violation of the Administrative Procedure Act. This decision marks a setback in rulemaking attempts by the SEC.

Chamber of Commerce v. SEC, case no. 23-60255, in the U.S. Court of Appeals for the Fifth Circuit.