Securities Regulation Law Journal

Volume 49 Number 3 Fall 2021

THOMSON REUTERS

Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (April 1, 2021 - June 30, 2021)

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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 April 1, 2021 through June 30, 2021.

The SEC finalized one new, technical rule for implementation, and proposed one new rule for this quarter. Due to new leadership at the SEC, there has been a lack of rulemaking during this quarter. Gary Gensler was sworn into office as the Chair of the SEC on April 17, 2021. The SEC's new administration has been undergoing a rigorous review of current SEC rules and policies.

On June 11, 2021, the SEC released its near-term regulatory agenda, outlining several areas that the SEC expects to propose new rules for within the next year. Proposals regarding private offerings, climate change risk disclosures, board diversity disclosures, and "gamification" in stock markets were included in the agenda. With the lack of rulemaking this quarter, this article will discuss rules that may be proposed by the SEC, as well as certain areas of interest that the SEC is reportedly reviewing.

Raising Accredited Investor Thresholds for Private Offerings

The SEC is considering stricter rules to Regulation D private offerings. In particular, the SEC is considering raising the accredited investor threshold, which determines who is eligible to invest in private securities offerings. For a natural person to qualify as an accredited investor, an annual salary of $200,000 a year for multiple years or net worth of $1 million (excluding primary home value) is generally required. Last year, the SEC expanded the definition of an accredited investor to include,

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among others, brokers and holders of certain financial credentials. The financial thresholds, however, have not been revised since 1982.

Proponents of higher thresholds argue that increasing these thresholds will improve protection of investors who are involved in private offerings. As overall wealth grows and threshold levels remain unchanged, more people can qualify as accredited investors and, as a result, have access to private offerings. Currently, about 13% of the U.S. population can qualify as an accredited investor, compared to just 2% in 1983, according to SEC data. Commissioners Allison Herren Lee and Caroline Crenshaw expressed concern that, despite qualifying as accredited investors, unsuspecting investors could be targeted in private offerings, which have minimal disclosure or ongoing reporting obligations, and would not have protections that are afforded to participants in registered offerings.

Climate Change Risk Disclosures

The SEC has been reviewing public comments regarding the best approach to update environmental, social and governance ("ESG") disclosure requirements. The SEC last released climate-related guidance in 2010, noting ways a company's climate risk activities could trigger disclosure obligations. Since then, investors have increasingly demanded more detailed information about risks that companies pose to the climate.

New disclosure requirements would seek to provide more details to inform investors about an issuer's known risks, uncertainties, impacts and opportunities regarding climate change, and achieve greater consistency across companies and industries. SEC Chair Gensler has maintained that increasing ESG disclosures is one of his top priorities. A new rule may be proposed by the end of 2021, requiring disclosure of:

- Material climate change related information in filings, such as on Form 10-K
- "Scope 1 and Scope 2 greenhouse gas emissions", which are direct emissions from a company's operations and indirect emissions from purchased energy sources that are consumed by the company
- Quantitative metrics used to measure exposure to climate change risk

Board Diversity Disclosures

The SEC's near-term regulatory agenda also included proposals to add disclosures regarding diversity of board members and nominees. Previous rules, first implemented in 2009, only require

companies to "disclose if and how diversity is considered as a factor in the process for considering candidates for board positions," while subsequent staff guidance has encouraged "disclosure of self-identified characteristics of board candidates."

Additionally, current Regulation S-K requirements give companies discretion to determine what diversity information is material and needs to be disclosed. The leniency in disclosure has led to underwhelming and inconsistent information from few companies. New disclosure requirements could require companies to disclose information beyond the 2009 rules and the current principle-based requirements under Regulation S-K. Commissioner Allison Herren Lee has advocated for requiring disclosure of workforce diversity data at all levels of seniority.

The substance of a new SEC rule could be influenced by the SEC's pending approval of the board diversity rule proposed by Nasdaq. The proposed rule would generally require Nasdaq-listed companies to disclose certain board diversity-related statistics and have at least two directors who are self-reportedly diverse or explain why they are unable to meet that requirement. Within five years of the rule's enactment, all Nasdaq-listed companies would be required to have at least one female director and one director from an underrepresented minority group. Nasdaq's proposed rule generally follows recent legislation in California mandating board diversity.

"Gamification" in Stock Trading Apps

New rules are also expected in response to the stock market volatility prompted by the "meme stock" trading in early 2021. SEC Chair Gensler expressed concern about mobile stock trading apps using "gamification, behavioral prompts, predictive analytics, and differential marketing" to encourage trading, which can pose risks to average traders. Gamification is commonly used by apps to increase user activity. App notifications, reminders, achievements and other psychological tools are used by trading and investing apps, such as Robinhood, to make buying and selling stocks easy, encouraging and ever-present to average investors.

Chair Gensler has publicly stated that the SEC may be required to evaluate and update the rules related to trading and investing apps, recognizing that many of the SEC's regulations were written before these recent technologies and communication practices became prevalent. Chair Gensler also referenced that if this issue is not addressed, the investing public, those saving for their future, retirement and education, may be adversely impacted.

United States Court of Appeals for the Ninth Circuit Revisits Securities Fraud Allegations against Google's Parent Company, Alphabet Inc.

On June 16, 2021, the United States Court of Appeals for the Ninth Circuit restored a securities fraud action brought by the State of Rhode Island and other investors (collectively, "Plaintiffs") against Google, Inc. ("Google"), Alphabet Inc. ("Alphabet"), Google's parent company, and members of Alphabet's Board of Directors (collectively "Defendants"). Plaintiffs alleged that Defendants violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder, and Section 20(a) of the Securities Exchange Act, by omitting material facts relating to Google's customer data breach.

Plaintiffs alleged that Defendants intentionally failed to disclose information concerning bugs in its database in its SEC filings. In 2018, Alphabet admitted it found a software glitch that potentially compromised Google+ users' private data. Investors subsequently sued Defendants and thereby alleged public investors were deceived and share price were inflated between the discovery and disclosure of the bug.

Rhode Island challenged 12 statements in Alphabet's Form 10-Qs related to the software issues. The Ninth Circuit reversed in part the lower court's dismissal while focusing on a limited number of allegedly misleading statements. One stated "there have been no material changes to our risk factors since our Annual Report on Form 10-K for the year ended December 31, 2017." The Court concluded that Plaintiffs' allegations adequately alleged that Alphabet knew about the security bugs and intentionally did not disclose such information in its 10-Qs.

Rhode Island v. Alphabet, Inc., No. 20-15638 (9th Cir. June 16, 2021).

Investors Fall Short of Scienter Pleading Requirements in Rule 10b-5 Action against Fifth Third Bancorp

On April 27, 2021, the United States District Court for the Northern District of Illinois dismissed a securities fraud action against the bank Fifth Third Bancorp ("Fifth Third") and its executives (collectively, "Defendants"). The suit alleged Defendants failed to disclose a federal investigation into Fifth Third's alleged practices of opening of unauthorized accounts in the name of unsuspecting consumers. A class of the bank's investors ("Investors" or "Plaintiffs"), led by Heavy & General Laborers' Local 472 & 172 Pension and Annuity Funds, alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10(b)-5.

In 2016, the Consumer Financial Protection Bureau ("CFPB") notified Fifth Third that it was commencing an investigation into allegations that Fifth Third employees opened customer accounts without authorization. This conduct was allegedly influenced by the bank's aggressive cross-selling strategy and incentive program which the bank failed to properly police. The CFPB later sued the bank in March 2020. Investors claimed that subsequent public communications by Fifth Third's executives which failed to disclose the CFPB investigation or lawsuit were made to intentionally deceive investors about resulting reputational or regulatory risks. Defendants moved to dismiss.

The United States District Court for the Northern District of Illinois granted Defendants' motion to dismiss, reinforcing the importance of pleading facts with particularity in securities fraud actions. The Court found that Plaintiff's complaint did not allege sufficient, specific facts to satisfy the Private Securities Litigation Reform Act's (PSLRA) heightened scienter pleading requirement for securities fraud. The Court found that Plaintiffs did not adequately show the executive's actual knowledge of the bank's underlying wrongdoing, nor did they specify each alleged misleading statement and the reason or reasons for why it is misleading. The Court reasoned that the allegations of Defendants' knowledge of the CFPB's investigation "demonstrate[d] [that] at this stage . . . [Defendants] knew of the investigation, not necessarily of the problem itself."

Heavy & Gen. Laborers' v. Fifth Third Bancorp, Case No. 20 C 2176 (N.D. Ill. Apr. 26, 2021).