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# Skadden provides SEC Rulemaking Update: A Year of Changes, With More to Come

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**Comment** G+1

Last year, the Securities and Exchange Commission (SEC) made major progress in completing its rulemaking mandates under the Jumpstart Our Business Startups Act (JOBS Act) and the Dodd-Frank Act. Additionally, Congress enacted the Fixing America's Surface Transportation Act (FAST Act), which made a number of key changes to federal securities laws, including creating new accommodations for initial public offerings (IPOs) by emerging growth companies (EGCs), private resales of securities and reduced or streamlined disclosures for public companies.

Many of these changes became effective in 2015 or are expected to become effective in 2016, leading to the prospect of both new capital-raising opportunities and updated disclosure obligations for companies. Beyond rulemaking changes, the SEC itself is likely to be reshaped in 2016 with the arrival of two new SEC commissioners who will bring their own perspectives on the issues facing the agency, and the election of a new president, which could result in a new SEC chairman.

**Capital Formation Changes**

On December 4, 2015, President Barack Obama signed into law the FAST Act, which contained a number of capital formation provisions that have been referred to as "JOBS Act 2.0." The provisions ease the Securities Act registration process for EGCs in several ways, allowing them greater flexibility in assessing market conditions and determining the timing of their IPO launch; greater certainty regarding the use of EGC benefits during the registration process; and the ability to avoid the expense of preparing certain financial statements that would be unnecessary at the time of the offering.

In addition, with the SEC's completion of the JOBS Act rulemakings, companies have new avenues for raising capital. In March 2015, the SEC adopted final rules expanding Regulation A, an existing exemption from Securities Act registration for smaller issuances of securities. Often referred to as "Regulation A+," the new exemption allows eligible companies to sell up to $50 million of securities in a 12-month period, subject to certain disclosure and reporting requirements.

In October 2015, the SEC adopted final rules for equity crowdfunding, which allows companies to raise capital by soliciting small investments from a large number of investors. The new Regulation Crowdfunding rules permit an eligible company to raise up to $1 million through crowdfunding offerings in a 12-month period. All transactions relying on the new rules are required to take place through an SEC-registered broker-dealer or funding portal.

Companies should consider the impact of the new Securities Act registration exemption the FAST Act created for private resales to accredited investors. Under the new Section 4(a)(7) exemption, a resale would be exempt from registration as long as:

1. the purchaser is an accredited investor as defined in Rule 501 of Regulation D;
2. the seller (or any person acting on the seller's behalf) does not use general solicitation to offer securities;
3. the seller and prospective purchaser obtain certain information from the issuer for situations in which the issuer is not subject to Exchange Act reporting obligations;
4. neither the seller (nor any person compensated for the sale) is subject to an event that would trigger the "bad actor" disqualification provision of Securities Act Rule 506(d);
5. the securities have been outstanding for at least 90 days prior to the date of the resale; and
6. the securities are not part of an unsold allotment to an underwriter (such as an investment bank acting as an underwriter in an IPO).

Consistent with its purpose of facilitating resales, the new exemption is not available for sales by the issuer or its subsidiaries but is available for other affiliates of the issuer. The exemption should provide security holders of private companies greater trading liquidity for their securities and may give rise to a marketplace for sales of securities of private companies. At the same time, the issuer information requirement will place greater pressure on private companies to publicly disclose information.

**Disclosure Modernization**

Reforming the disclosure requirements for public companies continued to be a priority for the SEC and Congress in 2015. In October 2015, the SEC issued a request for public comment on the need for possible changes to Regulation S-X, which covers financial information. The release, which is the first product resulting from the SEC's Disclosure Effectiveness project, focuses on disclosure requirements for certain entities other than a registrant, such as financial statements of a target company in a business acquisition. The next phase of the SEC's Disclosure Effectiveness project will focus on Regulation S-K, with the SEC expected to solicit public comment on these disclosure requirements in 2016. Public comments largely will determine whether the SEC will then propose and implement changes to these requirements.

Congress, in the meantime, continued to press for changes that would reduce the disclosure burdens on public companies. In addition to the Disclosure Effectiveness project, the FAST Act requires the SEC to undertake new studies and rulemakings to simplify disclosure requirements. Companies should begin to see the first results of these new efforts in 2016.

**FASB's New Lease Accounting Standards and Materiality Proposals**

The Financial Accounting Standards Board (FASB) voted in November 2015 to issue new lease accounting standards for companies under generally accepted accounting principles (GAAP) that also will impact financial statements. The long-awaited standards are intended to increase transparency for investors and will require companies to include leases (operating and capital) in their financial statements instead of disclosing leases in the notes to those statements. The changes will impact companies that rely heavily on leases, causing an increase in their balance sheets and potentially posing issues for complying with existing debt covenants. Companies should review their indentures and credit agreements to determine if any covenants will be implicated, particularly maintenance covenants. However, the impact may be limited in some markets, such as in high-yield bonds, where indentures often contain provisions limiting the impact of changed accounting principles or freezing GAAP. Companies entering into indentures and credit agreements should also take this change into consideration.

The final accounting standards are scheduled to be published in early 2016. Public companies must comply for fiscal years and interim periods beginning December 15, 2018, and retroactive to annual and interim statements for 2017 and 2018. Private companies must comply for annual periods beginning December 15, 2019, and retroactive to financial statements for 2018 and 2019.

Separately, in September 2015, FASB issued two proposals intended to clarify the concept of materiality in financial reporting and eliminate unnecessary disclosures in financial statements. The first proposal would amend Chapter 3 of FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting, to clarify that materiality is a legal concept not defined by FASB. The proposal removes any existing discussion of materiality in Chapter 3 and replaces it with a broad reference to the U.S. Supreme Court's definition of materiality. Under this framework, information would be considered material if there is a substantial likelihood that a reasonable investor would view its omission or misstatement as having significantly altered the total mix of information. The second proposal promotes the use of discretion in determining which disclosures are material. This proposal stresses that materiality applies to quantitative and qualitative disclosures, both individually and in the aggregate in the context of financial statements taken as a whole. Nondisclosure due to immateriality would not be considered an accounting error. Comments were due on both proposals in early December 2015.

**Conclusion**

Further changes are on the horizon for 2016. Congress continues to show great interest in effecting policy goals through legislative modifications to the federal securities laws. Recent bills have been introduced in Congress that would change the accredited investor definition used for determining investors eligible to participate in private offerings, to expand the number of investors that can rely on the definition. In addition, the bills introduced new disclosure requirements for public companies regarding their directors' expertise in cybersecurity. Political contributions disclosure remains a hot topic for the SEC, which also is expected to continue completing the rulemakings mandated by the JOBS Act, Dodd-Frank Act and FAST Act.

*The preceding post is based on a memorandum published by Skadden, Arps, Slate, Meagher & Flom LLP in January 2016, which is available here.*