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What's next from the SEC?

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REITWise 2017: What's Next from the SEC?

March 9, 2017

Agenda

What to expect from the Securities and Exchange Commission under the new administration

- Challenges to the Commission's independence and regulatory roll-back efforts
- The Choice Act
- Capital formation related developments
- Investment management developments
- Enforcement developments

“Regulatory Accountability” Measures

Regulatory Accountability Act

Regulatory Accountability Act	
Revise Rulemaking Procedures Under the Administrative Procedures Act ("APA")	• Would revise federal rulemaking procedures under the APA to require applicable federal agency to make all preliminary and final factual determinations based on certain *evidence*.

Consideration of Numerous Factors Prior to Issuing Rule	• Federal agency must consider, among other factors, the:
	  • legal authority under which a rule may be proposed;
	  • specific nature and significance of the problem the rule addresses; and
	  • any reasonable alternatives.

New Rulemaking Notice Requirements	• Rulemaking notice requirements would be revised to require agencies to, among other things:
	  • publish in Federal Register advance notice of proposed rulemaking involving a "major" or "high-impact rule;"
	  • hold a hearing before the adoption of any "high-impact rule;" and
	  • provide interested persons with an opportunity to participate in the rule-making process.

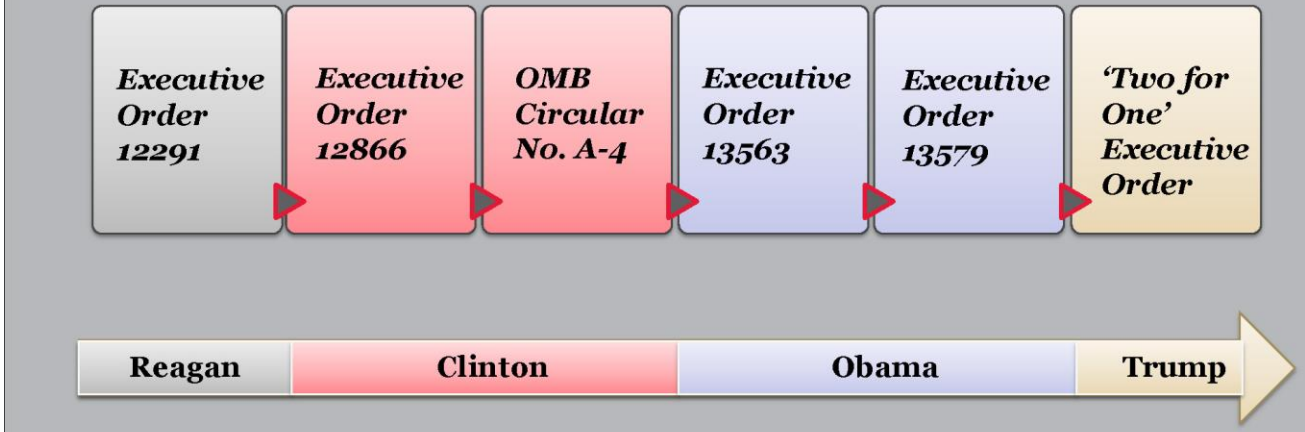
SEC Regulatory Accountability Act

SEC Regulatory Accountability Act	
Revisions to the Exchange Act	SEC would be directed to: • identify the nature and source of the problem that the proposed regulation is designed to address (prior to issuing a regulation under the securities laws); • adopt regulations only after a determination that its benefits justify its costs; • identify and assess available alternatives to any regulation; and • ensure that regulation is accessible, consistent, written in plain language, and easy to understand.
Determination of Cost and Benefits	The SEC would be required to consider a rule's impact on investor choice, market liquidity, and small businesses (*cf.* current standard under *Business Roundtable v. SEC* ("[SEC's] statutory obligation [is] to determine as best it can the economic implications of the rule.").
Additional Obligations of the SEC	• Periodically review its existing regulations to determine if they are outmoded, ineffective, insufficient, or excessively burdensome; and • In accordance with such review, modify, streamline, expand, or repeal them.
"Major" Rule Adoption or Amendment	SEC would be required to state in its adopting release: • the regulation's purposes and intended consequences; • metrics for measuring the regulation's economic impact; • the assessment plan used to assess if the regulation has achieved its stated purposes; and • any foreseeable unintended or negative consequences of the regulation.

Presidential Actions in 2017

- On January 30, 2017, President Trump issued an Executive Order, titled *Reducing Regulation and Controlling Regulatory Costs*.
  - Notes that the policy of the executive branch is to be "prudent and financially responsible in the expenditure of funds, from both public and private sources."
  - Establishes a regulatory cap for fiscal year 2017—unless prohibited by law, whenever an executive department or agency publicly proposes for notice and comment (or otherwise promulgates a new regulation), it must identify at least two existing regulations to be repealed.
- On February 2, 2017, the Office of Information and Regulatory Affairs issued its *Interim Guidance Implementing Section 2 of the Executive Order of January 30, 2017*.
  - Explains that departments and agencies may comply with the requirements of the Executive Order "by issuing two 'deregulatory' actions for each new significant regulatory action that imposes costs."

Cost-Benefit Requirements Within the Rulemaking Process



Cost-Benefit Requirements Within the Rulemaking Process: Pre-Trump

- ***Executive Order 12291 (Feb. 1981).***
  - Regulatory Impact Analysis must be conducted in connection with every "Major Rule."
  - Must contain a description of the potential: (i) benefits of rule; (ii) costs of rule; and (iii) net benefits of rule.
- ***Executive Order 12866 (Oct. 1993)*** *(revokes Executive Order 12291).* Agencies should assess all costs/benefits of viable regulatory alternatives, including the alternative of not regulating.
  - "Significant" regulatory actions must be submitted to Office of Information and Regulatory Affairs ("OIRA") for review.
- ***OMB Circular A-4 (Sept. 2003).*** Designed to ". . . standardiz[e] the way benefits and costs of Federal regulatory actions are measured and reported."
  - "Good regulatory analysis" encompasses: (i) a statement of the need for a proposed action; (ii) an examination of alternative approaches; and (iii) an evaluation of benefits and costs, including cost-benefit and cost-effectiveness analyses.
  - To properly evaluate costs and benefits of regulations and alternatives, an agency must:
    - Explain how the actions required by the rule are linked;
    - Identify a baseline; and
    - Identify the expected undesirable side-effects and ancillary benefits.
  - "Opportunity cost" is the appropriate concept for valuing benefits and costs.
    - "Willingness-to-pay" captures the notion of opportunity cost.
    - However, "willingness-to-accept" can also be instructive.

- ***Executive Order 13563 (Jan. 18, 2011)***
  - Regulatory system must "take into account benefits and costs, both quantitative and qualitative" and measure "the actual results of regulatory requirements.
  - Each executive agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.
  - Where feasible, executive agencies should consider values that are "difficult or impossible to quantify" (e.g., equity, human dignity, fairness and distribute impacts).
- ***Executive Order 13579 (July 11, 2011)***
  - Extends Executive Order 13563 to independent regulatory agencies.
  - Independent regulatory agencies should consider how best to promote "retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome . . ."

Pre-Trump, cont'd.

Core Principles for Regulating the United States Financial System

- On February 3, 2017, President Donald Trump signed the Executive Order on Core Principles for Regulating the United States Financial System. The order outlined seven principles of regulation, or "Core Principles", which the Trump Administration will follow to regulate the U.S. financial system. The principles were listed as follows:
  - Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;
  - Prevent taxpayer-funded bailouts;
  - Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;
  - Enable American companies to be competitive with foreign firms in domestic and foreign markets;
  - Advance American interests in international financial regulatory negotiations and meetings;
  - Make regulation efficient, effective, and appropriately tailored; and
  - Restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework.

The Choice Act

The Financial Choice Act

- The Financial Choice Act of 2016 (the "Choice Act") is viewed as the first major concerted effort to provide an alternative to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") as a way to end "Too Big to Fail."
- As currently drafted, the Choice Act would impact U.S. securities laws by:
  - Repealing a number of the specialized disclosure provisions contained in the Dodd-Frank Act; and
  - Subsuming various "JOBS Act 2.0" capital formation measures that have largely been presented as standalone bills.

The Choice Act

Reforms to Title IX of the Dodd-Frank Act:	
Fiduciary Duty Rule	• Requires the SEC to report to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs on certain matters before promulgating a heightened standard of conduct for broker-dealers.
Asset-Backed Securities and Credit Rating Agencies	• Eliminates the risk retention requirements for certain asset-backed securities. • Repeals the Franken Amendment.
Relief for Smaller Issuers	• Modifies threshold for ability to rely on the exemption from Section 404(b) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley").
Executive Compensation, Incentive-Based Compensation, and Pay Ratio Disclosure	• Repeals the Dodd-Frank Act provisions relating to incentive-based compensation and pay ratio disclosures.

The Choice Act: Reforms Affecting Capital Formation

Title X of the Financial Choice Act			
Simplification of Small Business Mergers, Acquisitions, Sales, and Brokerage	Encouraging Employee Ownership	Foster Innovation Through Temporary Exemption for Low-Revenue Issuers	Safe Harbor for Micro Offerings
Simplification of Small Company Disclosure Requirements	SEC Overpayment Credit	Enhance Small Business Capital Formation	Improvements to Private Placements
Accelerating Access to Capital	Fair Access to Investment Research	Revisions to the Prohibition Against General Solicitation and Advertising	Investor Limitations for Qualifying Venture Capital Funds
Establishment of an SEC Small Business Advocate	Small Business Credit Availability	Venture Exchanges	Adjustments to Crowdfunding Regime

- ***Simplification of Small Business Mergers, Acquisitions, Sales, and Brokerage***. Amends Section 15(b) of the Exchange Act to exempt an "M&A broker" from Exchange Act registration.
- ***Encouraging Employee Ownership***. Increases the threshold for disclosures relating to compensatory benefit plans.
- ***Simplification of Small Company Disclosure Requirements.*** EGCs and issuers with less than $25 billion in total annual gross revenues would be exempt from Extensible Business Reporting Language requirements for financial statements and other periodic reporting.
- ***SEC Overpayment Credit.*** New mechanism for the refunding or crediting of overpayment of fees paid in connection with Section 31 of the Exchange Act.

Reforms to Capital Formation, cont'd.

Reforms to Capital Formation, cont'd.

- ***Fair Access to Investment Research.*** Expands the safe harbor for investment fund research provided by Rule 139 under the Securities Act.
- ***Accelerating Access to Capital.*** Expands the eligibility for use of a registration statement on Form S-3.
- ***Establishment of an SEC Small Business Advocate.*** Amends Section 4 of the Exchange Act by establishing within the SEC an "Office of the Advocate for Small Business Capital Formation."
- ***Small Business Credit Availability.*** Requires that the SEC promulgate regulations to codify the terms of an exemptive application already issued to a business development company ("BDC") allowing the BDC to own interests in an investment adviser.
- ***Foster Innovation Through Temporary Exemption for Low-Revenue Issuers.*** Provides a temporary exemption for "low-revenue issuers" from Section 404(b) of the Sarbanes-Oxley Act.

Reforms to Capital Formation, cont'd.

- ***Enhance Small Business Capital Formation.*** Amends Section 503 of the Small Business Investment Incentive Act by requiring the SEC to review the findings and recommendations of the Government-Business Forum on Capital Formation.
- ***Revisions to the Prohibition Against General Solicitation and Advertising.*** Requires the SEC to revise Reg D to reflect the guidance contained in the *Michigan Growth Capital Symposium* no-action letter.
- ***Venture Exchanges.*** Amends Section 6 of the Exchange Act by enabling a national securities exchange to elect to be treated as a "venture exchange."
- ***Safe Harbor for Micro Offerings.*** Provides a safe harbor from Section 4 of the Securities Act for certain micro offerings.
- ***Improvements to Private Placements.*** Amends Reg D in an attempt to ensure that the proposed amendments released by the SEC in July 2013 would be foreclosed from being adopted.

- ***Investor Limitations for Qualifying Venture Capital Funds.*** Amends Section 3(c)(1) of the Investment Company Act by allowing a "qualifying venture capital fund" to maintain holders of up to 250 U.S. persons without having to register under the Investment Company Act.
- ***Adjustments to Crowdfunding Regime.*** Adds a new provision under Section 4(a)(6) of the Securities Act, which would provide an exemption for securities offered by certain issuers:
  - Public float less than $75 million as of most recent semi-annual period; *or*
  - Where total public float is zero, annual revenues of less than $50 million as of most recently completed fiscal year.
- ***Corporate Governance Reform and Transparency.*** Requires "proxy advisory firms" to register under the Exchange Act before providing proxy voting research, analysis, or recommendations to any client.

Reforms to Capital Formation, cont'd.

The Choice Act: Repeal of Certain Specialized Public Company Disclosures

Would repeal the following provisions of the Dodd-Frank Act:	
Section 1502	• Requires certain persons to disclose annually whether any "conflict minerals" are necessary to the functionality or production of a product of the person originated in the Democratic Republic of the Congo or an adjoining country.
Section 1503	• Requires the SEC to promulgate rules that require an issuer that files reports pursuant to Section 13(a) or Section 15(d) of the Exchange Act and is an operator, or maintains a subsidiary that is an operator, of a coal or other mine to include, in each periodic report filed with the SEC, certain information for the time covered by the report.
Section 1504	• Requires that the SEC issue rules that require reporting issuers engaged in resource extraction activities, including the commercial development of oil, natural gas, or minerals, to disclose in their annual reports certain payments made to the U.S. federal government or a foreign government.

Changes to the as-introduced Version of the Financial Choice Act

- The Choice Act 2.0 contains additional provisions that would:
  - Modernize Section 12(g) registration requirements for smaller reporting companies.
    - Eliminate annual verification of accredited investor status; and
    - Increase revenue and shareholder thresholds.
  - Increase the exemption from registration as an investment company for "qualified angel funds" from 100 to 500 investors.
  - Increase the SEC Rule 701 threshold from $10 to $20 million with an inflation trigger.
  - Extend the ability to "test the waters" to all companies (not just EGCs).
  - Confidential filings will be available to all companies registering shares for sale for the first time.
  - Increase the Reg A+ $50 million threshold to $75 million per year plus the addition of an inflation trigger.

Aspects of the Choice Act Already in Motion: Pay Ratio Disclosure Rule

- The SEC adopted the Pay Ratio Disclosure Rule in August 2015 to implement Section 953(b) of the Dodd-Frank Act.
- The Pay Ratio Disclosure Rule requires a public company to disclose the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer.
- On February 6, 2017, Acting Chairman of the SEC Michael Piwowar requested public comment on any unexpected challenges that issuers have experienced in connection with complying with the Pay Ratio Disclosure Rule.

Aspects of the Choice Act Already in Motion: Public Company Disclosures

- On January 31, 2017, Acting Chairman of the SEC Michael Piwowar directed the SEC staff to "reconsider whether the 2014 guidance on the Conflict Minerals Rule is still appropriate and whether any additional relief is appropriate."
- On February 14, 2017, President Trump approved Congress' joint resolution to repeal the SEC's Resource Disclosure Rule.
  - The joint resolution was passed by Congress in February 2017 pursuant to the Congressional Review Act.
  - The Congressional Review Act permits Congress to, among other things, disapprove a final agency rule within 60 days from when it was issued.

Other Capital Formation Matters

Capital formation related measures

- The SEC will have an opportunity to continue to advance the efforts already underway, including the following:
  - The Disclosure Effectiveness initiative
  - Amending the Smaller Reporting Company definition
  - Amending the accredited investor definition

Disclosure Effectiveness

- The SEC's April 13, 2016 concept release asks many questions about the disclosure of business and financial information required by Regulation S-K; prior to that, the SEC had solicited comments in 2015 regarding concepts related to financial statements required under Regulation S-X
- The broader disclosure effectiveness efforts have been wide-ranging and have encouraged voluntary efforts to improve disclosure in periodic reports
- It is particularly difficult to predict how and when concepts may turn into actual rulemaking

- ***Financial Information and the MD&A***: The release discusses the Commission's guidance over the years on the objectives of the MD&A section, the use of an executive-level overview and the types of trend data that the Commission has sought. In this regard, the release requests comment on various matters, including whether the sources of Commission guidance on MD&A should be consolidated, whether a different format or presentation should be required, and whether auditor involvement should be required.
- ***Risks and Risk Management***: The release asks whether all risk related disclosures required to be included in a report should be consolidated, and whether this would improve the quality of the information.
- ***Line Item Requirements***: The Concept Release also seeks comment regarding specific items of Regulation S-K.
- ***Industry Guides***: Consistent with the JOBS Act Regulation S-K study, the release solicits comments on the various industry guides.
- ***Exhibits***: The release also seeks input on Item 601 of Regulation S-K related to exhibit requirements.

Disclosure Effectiveness, cont'd.

Disclosure Effectiveness, cont'd.

- ***Principles-Based Disclosures or Prescriptive Disclosures***: The Concept Release raises the age-old "principles-based" versus "prescriptive" disclosure question. The release solicits input on the most effective approach as between principles-based and prescriptive disclosure requirements and offers up a third concept, "objectives-based" disclosure requirements for consideration.
- ***Investor Sophistication***: The Concept Release asks an important question that often is the very first question we ask when we are writing a memorandum or an alert: in crafting disclosures, what level of sophistication should be presumed of the reader?
- ***Scaled Disclosures***: Scaled disclosures are available to smaller reporting companies (SRCs) and the JOBS Act made certain disclosure accommodations available to EGCs.
- ***Frequency of Disclosures***: The release addresses the current debate regarding "short-termism" by acknowledging the possibility that quarterly disclosure requirements may lead management of public companies to focus on near term results rather than long-term investment.

Other Related Initiatives

- Revising industry guides
- Comment request on the "400 Series" of Regulation S-K
- Exhibit hyperlinking – final rule adopted March 1, 2017
- Inline XBRL – rule proposed on March 1, 2017

Smaller Reporting Companies

- On June 27, 2016, SEC proposed amendments to the definition of "smaller reporting company" (SRC) that would expand the number of companies that have this status.
- Under the proposed amendments, registrants with a public float of less than $250 million would qualify as SRCs. The amendments are intended to promote capital formation by reducing the burdens on SRCs without significantly altering the total mix of information available to investors.
- SRCs are eligible for a number of disclosure accommodations under Regulation S-K and Regulation S-X. The proposed amendments do not affect the scope of these existing scaled disclosure requirements. The Commission will review the scaled disclosure requirements as part of its Disclosure Effectiveness Initiative.
- The Commission is also proposing amendments to the definitions of "accelerated filer" and "large accelerated filer.

Smaller Reporting Companies, cont'd.

PROPOSED AMENDMENTS TO THE SMALLER REPORTING COMPANY DEFINITION		
Registrant Category	Current Definition	Proposed Definition
Reporting Registrant	Less than $75 million of public float at end of second fiscal quarter	Less than $250 million of public float at end of second fiscal quarter
Registrant Filing Initial Registration Statement	Less than $75 million of public float within 30 days of filing	Less than $250 million of public float within 30 days of filing
Registrant with Zero Public Float	Less than $50 million of revenues in most recent fiscal year	Less than $100 million of revenues in most recent fiscal year
Non-Smaller Reporting Company that Seeks to Qualify as a Smaller Reporting Company Based on Public Float	Less than $50 million of public float at end of second fiscal quarter	Less than $200 million of public float at end of second fiscal quarter
Non-Smaller Reporting Company with Zero Public Float that Seeks to Qualify as a Smaller Reporting Company	Less than $40 million of revenues in most recent fiscal year	Less than $80 million of revenues in most recent fiscal year

Examination and Enforcement Developments

Enforcement

- Changes can be expected
  - More cases being settled and less headline seeking enforcement litigation
  - Less onerous restrictions on foreign public companies
  - Less zealous enforcement of Foreign Corrupt Practice Act
    - Clayton has expressed views on a less zealous approach to FCPA, but that was before the DOJ and the SEC targeted many non-US Companies; the DOJ and the SEC collected a total of $1.8 billion in FCPA fines, penalties and disgorgement in 2016.
    - Clayton questioned the unilateral approach of the US and, since his comments, the DOJ and the SEC have accomplished much in building international coalitions and relationships with law enforcement agencies around the globe. In effect, the DOJ and the SEC have "institutionalized" global anti-corruption enforcement, and it will be extremely difficult for any future administration to dismantle this existing infrastructure.

Enforcement, cont'd.

- Changes can be expected (cont'd)
  - Settlements are more likely to seek new safeguards, not fines that punish stockholders
  - Less use of disclosure to promote corporate governance
    - Focus on financial disclosure meaningful to investors, not executive compensation
    - Possible reduced access to proxy statement disclosure by public interest groups
  - Scale back rules viewed as slowing economic growth
  - Emphasis on speed of review and increased effort to promote capital formation
  - Less emphasis on regulation and reduced oversight of asset managers