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U.S. securities law developments in 2020

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In 2020, the Securities and Exchange Commission (SEC) continued to focus on streamlining and modernizing disclosure requirements and expanding access to capital for smaller businesses. The SEC simplified financial disclosure requirements in merger and acquisition transactions and expanded the categories of investors and intermediaries that are able to participate in private placements. The SEC also revisited some of its proxy rules relating to third-party shareholder communications.

SEC expands accredited investor and qualified institutional buyer definitions

In August, the SEC issued final rules [PDF] expanding the definitions of "accredited investor" in Regulation D under the U.S. Securities Act of 1933 (the U.S. Securities Act) and "qualified institutional buyer" in Rule 144A under the U.S. Securities Act. These are the categories of individuals and entities that the SEC deems to have sufficient knowledge and experience to participate in U.S. private placements without the protections of the SEC's securities registration process. The new rules broaden the investor pool from which Canadian companies will be able to raise capital in U.S. private placements. The rules also resolve certain technical disqualifications (discussed below) that some Canadian institutional investors have faced when assessing their eligibility to participate in private placements limited to qualified institutional buyers.

The amendments to the "accredited investor" definition in Regulation D include the addition of a number of persons and entities

- natural persons who hold professional certifications, designations, status or other credentials from an accredited educational institution that the SEC has designated as qualifying an individual for accredited investor status, such as holders in good standing of Series 7, Series 65 and Series 82 licenses
- "knowledgeable employees" (as defined under the Investment Company Act of 1940 (Investment Company Act)) of private funds, if they are investing in the private fund that is offering the securities
- SEC- and U.S. state-registered investment advisors
- investment advisors exempt from registration under the U.S. Investment Advisers Act of 1940 (Advisers Act)

- limited liability companies with at least US$5 million in assets and not formed for the purpose of acquiring the securities offered
- “family offices” with at least US$5 million in assets under management, not formed for the purpose of acquiring the securities offered and whose investments are directed by a sophisticated person, and their “family clients” (each as defined under the Advisers Act)
- any type of entity not already covered by the definition of accredited investor, not formed for the specific purpose of acquiring the securities offered and that owns “investments” (as defined under the Investment Company Act) in excess of US$5 million

The amendments also provide that natural persons can combine assets or income of “spousal equivalents” (defined as a cohabitant occupying a relationship generally equivalent to a spouse) for purposes of satisfying the joint net worth or income thresholds.

The amendments to the definition of “qualified institutional buyer” in Rule 144A include the addition of a catch-all category for any institution that is not already specifically listed in the existing definition of qualified institutional buyer, but that (a) qualifies as an institutional “accredited investor” in Regulation D and (b) in the aggregate owns and invests on a discretionary basis at least US$100 million of securities of non-affiliated issuers. Importantly, unlike in the “accredited investor” definition in Regulation D, an entity qualifying under this new catch-all category is permitted to be formed as a qualified institutional buyer specifically for the purpose of acquiring the securities offered. Previously, certain Canadian investors owning at least US$100 million of securities of non-affiliated entities were precluded from participating in Rule 144A offerings because their form of organization was not specifically covered in the definition of “qualified institutional buyer.” With these changes, many of them are now likely able to use the new catch-all category to become “qualified institutional buyers.”

The amendments became effective on December 8, 2020.

SEC simplifies financial disclosures about acquisitions and dispositions of businesses

In May, the SEC adopted amendments to reduce the complexity of financial disclosure requirements in Regulation S-X relating to significant business acquisitions and dispositions involving SEC registrants. A registrant subject to Regulation S-X that acquires a business is generally required to provide separate audited annual and unaudited interim pre-acquisition financial statements of the acquired business if the acquisition would be significant to the registrant. Additionally, registrants are required to provide pro forma financial information reflecting adjustments intended to show how the acquisition or disposition might have affected the registrant’s financial statements had the transaction occurred at the start of the relevant financial period.

The amendments include several key aspects:

- The tests used to determine the significance of an acquisition or disposition have been modernized to more closely align with the actual economic significance of the transaction to the registrant. The amendments revise the “investment test” to compare the registrant’s investments in and advances to the acquired business to the registrant’s aggregate world-wide market value, if available. The amendments also revise the “income test” by adding a revenue component.

- Acquirors are permitted to use pro forma financial information in measuring significance.
- The financial statements of the acquired business are required to cover only the two most recently completed financial years instead of the three most recently completed financial years.
- Pro forma financial information may include management adjustments giving effect to synergies.
- It is no longer necessary to provide separate acquired business financial statements after the target has been consolidated into the registrant's financial statements for nine months or a complete fiscal year, depending on the level of significance.

Although the SEC's requirements for financial disclosures under Regulation S-X do not apply to Canadian registrants using Canada-U.S. Multijurisdictional Disclosure System (MJDS) forms, there are many cases where MJDS forms cannot be used. MJDS does not apply in certain types of merger and acquisition transactions, such as those in which a Canadian registrant acquires a U.S. domestic public company through a merger or a share exchange. In those cases, Regulation S-X will apply.

The final rules [PDF] will be effective on January 1, 2021, but voluntary compliance will be permitted in advance of the effective date.

SEC finalizes amendments to proxy rules applying to proxy advisory firms

In July, the SEC issued final amendments to its proxy rules to regulate certain activities of proxy voting advisory businesses (proxy advisors). Generally, the final rules are less prescriptive and more principles-based than those initially proposed by the SEC in December 2019.

These are the highlights of the final amendments:

- It is now clear that proxy voting recommendations by proxy advisors are "solicitations" that are subject to the SEC's proxy rules (including the prohibition on false or misleading statements).
- The exemptions from the SEC's proxy information and filing requirements are available to proxy advisors only if they
- include in their voting advice to clients specified disclosure relating to conflicts of interest
- adopt publicly disclosed policies designed to (i) ensure that registrants that are the subject of proxy voting advice have that advice made available to them at or prior to the time when the advice is disseminated to the proxy advisor's clients; and (ii) provide clients with a mechanism by which they can become aware, in a timely manner before the shareholders meeting, of any written statements by registrants that are the subject of the proxy voting advice

Unlike the December 2019 proposed rules, the final rules do not require proxy advisors to provide registrants with an advance draft of the proposed proxy voting advice for review and comment. The requirements to provide notice to a registrant of the proxy voting advice and to provide a mechanism to clients regarding written statements from the registrant do not apply to contested matters, most mergers and certain asset transactions.

Proxy advisors must comply with the new rules relating to conflicts and notice of advice by December 1, 2021. The SEC's proxy rules do not apply to Canadian registrants that are foreign private issuers under U.S. securities laws. However, the new rules may influence similar rulemaking under consideration in Canada.

SEC modernizes shareholder proposal rules

In September, the SEC adopted amendments modernizing the shareholder proposal rules under Rule 14a-8 of the Securities Exchange Act of 1934 (U.S. Exchange Act). These rules govern the process by which shareholders are able to submit proposals for inclusion in a registrant's proxy statement. The changes are intended to help ensure that shareholders demonstrate a meaningful economic stake or investment interest in a company before being able to use the company's resources to put their proposals before the registrant's other shareholders for consideration.

Highlights from the final rules [PDF] include

- replacing the current threshold, which requires holding at least US$2,000 or 1% of a registrant's securities for at least one year, with three alternatives requiring continuous ownership of
- US$2,000 of the registrant's securities for at least three years
- US$15,000 of the registrant's securities for at least two years, or
- US$25,000 of the registrant's securities for at least one year
- prohibiting multiple shareholders from aggregating their holdings for purposes of satisfying the amended ownership thresholds set out above
- requiring that a shareholder who elects to use a representative to submit a proposal for inclusion in the proxy statement provide the registrant with (1) documentation making it clear that the representative is authorized to act on the shareholder's behalf; and (2) a meaningful degree of assurance as to the shareholder's identity, role and interest in the proposal
- requiring that each shareholder-proponent state that the shareholder is able to meet with the registrant, either in person or via teleconference, no less than 10 calendar days, nor more than 30 calendar days, after submission of the proposal, and to provide contact information, as well as specific business days and times that the shareholder is available to discuss the proposal with the registrant
- revising the levels of shareholder support a proposal must receive to be eligible for resubmission at the same registrant's future shareholder meetings from 3%, 6% and 10% for matters previously voted on once, twice or three or more times in the last five years, respectively, with thresholds of 5%, 15% and 25%, respectively

The amendments will apply to any proposal submitted for an annual or special meeting to be held on or after January 1, 2022. A transition period will also allow holders meeting specified conditions to continue to rely on the US$2,000 for one year ownership threshold for proposals submitted for an annual or special meeting to be held prior to January 1, 2023.

Most Canadian SEC registrants qualify as foreign private issuers and therefore are not subject to the SEC's shareholder proposal and other proxy rules.

SEC proposes conditional exemption for finders assisting small businesses with capital raising

In October, the SEC proposed a conditional exemption [PDF] that would allow certain natural persons to participate in limited activities on behalf of issuers without having to register with the SEC as broker-dealers. The proposed exemption is intended to help issuers that may not be large enough to attract the assistance of a registered broker-dealer to have a path to raising capital.

For years, there has been uncertainty about the dividing line between the activities of a finder and those of a broker-dealer required to be registered with the SEC. Under the proposed conditional exemption, the SEC would create two tiers of exempt finders. Tier I finders would only be permitted to provide potential investors' contact information to a single issuer in relation to a single offering during a 12-month period and may not have any contact with potential investors. Tier II finders would be permitted to directly solicit investors on behalf of an issuer. In that case, however, those solicitation-related activities would be limited to (i) identifying, screening and contacting potential investors; (ii) distributing issuer offering materials to investors; (iii) discussing issuer information included in any offering materials, but without providing advice as to the valuation or advisability of the investment; and (iv) arranging or participating in meetings with the issuer and investor.

The finders exemption would only be available where

- the issuer is not an SEC reporting company and will conduct the securities offering in reliance on an exemption from registration under the U.S. Securities Act
- the finder does not engage in a general solicitation
- the potential investors are "accredited investors" as defined in Rule 501 of Regulation D under the U.S. Securities Act or the finder reasonably believes the potential investors are accredited investors
- the finder provides services under a written agreement with the issuer that includes a description of the services provided and associated compensation
- the finder is not an associated person of a broker-dealer
- the finder is not subject to "statutory disqualification," as defined under Section 3(a)(39) of the U.S. Exchange Act, at the time of his or her participation

The proposed conditional exemption is not available to finders operating through legal entities, in connection with registered securities offerings or offerings by a SEC reporting issuer, in connection with resales of existing securities or in transactions involving non-accredited investors. The proposed exemption was open for comments until November 12.

Final note

The general trend in U.S. securities regulation over the last several years has been on facilitating access to capital and downsizing the scope and extent of disclosure requirements applying to public companies, particularly smaller companies. With the announced year-end departure of SEC Chairman Jay Clayton, it remains to be seen if that trend will continue.