Client Alert

July 2018

SEC Votes to Approve New Rules and Proposed Rules on a Variety of Topics Applicable to Public Companies

On June 28, 2018, the Securities and Exchange Commission (SEC) approved three final rules and two rule proposals that SEC Chairman Jay Clayton says make "steady, thoughtful progress" on the SEC's "regulatory flexibility agenda." This client alert discusses the following in greater detail:[1]

1. final rules modernizing the definition of "smaller reporting company";
2. final rules implementing the use of Inline eXtensible Business Reporting Language (XBRL); and
3. proposed rules amending the SEC's whistleblower program.

Increased Smaller Reporting Company Thresholds

Following increasing pressure from both government and industry stakeholders, the SEC unanimously voted to amend the definition of "smaller reporting company" (SRC) by increasing the public float and revenue threshold requirements.[2] These amendments, first proposed in June 2016, will allow more companies to provide scaled disclosure under the various SEC regulations.

The new SRC definition enables a company with a public float of less than $250 million to qualify as an SRC. A company with no public float or with a public float of less than $700 million will qualify as an SRC if it had annual revenues of less than $100 million during its most recently completed fiscal year. The rules will become effective 60 days after publication in the Federal Register, which, based on past practice, would be expected to place the effective date in September of this year.

Criteria	Previous SRC Definition	Revised SRC Definition
Public Float	Public float of less than $75 million	Public float of less than $250 million
Revenues	Less than $50 million of annual revenues and no public float	Less than $100 million of annual revenues and • no public float, or • public float of less than $700 million

Consistent with the previous definition, if a company fails to qualify as an SRC, after initially qualifying as an SRC, it may provide scaled disclosure through the end of the fiscal year, but in order to requalify as an SRC, the company must meet more stringent qualification thresholds. The more stringent qualification thresholds are set to 80% of the initial qualification thresholds:

[1] The SEC also approved the following, which are beyond the scope of this client alert:

1. final rules relating to disclosures of liquidity risk management for open-end funds; and
2. proposed rules permitting certain exchange-traded funds (ETFs) to operate without first obtaining a fund-specific exemptive order.

[2] The full text of the final rule is available here.

Criteria	Previous SRC Definition	Revised SRC Definition
Public Float	Public float of less than $50 million	Public float of less than $200 million, if it previously had $250 million or more of public float
Revenues	Less than $40 million of annual revenues and no public float	Less than $80 million of annual revenues, if it previously had $100 million or more of annual revenues; and Less than $560 million of public float, if it previously had $700 million or more of public float

It is important to note that the changes to the SRC definition do not modify the thresholds enumerated in the definition of "accelerated filer." As a result, a company may qualify as an SRC but remain subject to the requirements of an accelerated filer, which include, among other things, the requirement to provide an independent registered public accountant's attestation of management's assessment of internal control over financial reporting required by Section 404(b) of the Sarbanes-Oxley Act of 2002. However, SEC Chairman Clayton has requested that the SEC staff recommend changes to the definition of accelerated filer in order to reduce the number of companies that qualify as accelerated filers.

In a related change, the SEC also approved amendments to Rule 3-05(b)(2)(iv) of Regulation S-X to increase the net revenue threshold in that rule from $50 million to $100 million. As a result, a company may omit financial statements of an acquired (or to be acquired) business for the earliest of the three fiscal years otherwise required by Rule 3-05 if the net revenues of that business are less than $100 million.

Inline XBRL

The SEC voted to adopt amendments to the XBRL requirements for operating companies and funds, which will now require the use of Inline XBRL for operating company financial statement information and fund risk/return summary information.[3] Inline XBRL involves embedding XBRL data directly into the filing so that the disclosure document is both human-readable and machine-readable. Inline XBRL (as opposed to the XBRL used currently) promises a number of benefits and efficiencies, including increased accuracy and transparency of the XBRL data embedded into public filings. The amendments are part of the SEC's initiative to modernize and improve the quality and accessibility of XBRL data while decreasing the cost of submitting financial information to the SEC.

Although the amendments modify the existing XBRL requirements, they do not change the categories of filers or scope of disclosures subject to the XBRL requirements. As noted in the table below, these changes will be implemented on a phased basis for operating companies according to filing status and for funds according to size. Upon the effective date of the new Inline XBRL requirement for a particular operating company or fund, the requirement to post XBRL data on a company or fund website will be eliminated.

Operating Company Filer Status	Compliance Date (beginning with fiscal periods ending on or after)[(a)]
Large accelerated filers that use US GAAP	June 15, 2019
Accelerated filers that use US GAAP	June 15, 2020
All other filers	June 15, 2021

(a) Filers will be required to comply beginning with their first Quarterly Report on Form 10-Q filed for a fiscal period ending on or after the applicable compliance date.

[3] The full text of the final rule is available here.

Investment Fund Size	Compliance Date
Large fund groups (net assets of $1 billion or more as of the end of their most recent fiscal year)	Two years after the effective date of the amendments
All other funds	Three years after the effective date of the amendments

Proposed Amendments to Whistleblower Program

The SEC is proposing amendments intended to strengthen its existing whistleblower program, which was established in 2010.[4] Section 21F of the Securities Exchange Act of 1934, as amended (Exchange Act), provides, among other things, that the SEC shall pay an award to eligible whistleblowers who voluntarily provide the SEC with original information about a violation of the federal securities laws that leads to the successful enforcement of a covered judicial or administrative action, or a related action. In the release detailing the proposed amendments, the SEC described the success of the program, noting that it has received over 22,000 whistleblower tips since its inception. Information provided by whistleblowers has led to enforcement actions ordering over $1.4 billion in financial remedies and, as a result, the SEC has ordered over $266 million in whistleblower awards to 55 individuals.

The bulk of the amendments would provide the SEC additional tools in award determinations.

- Currently, the SEC's whistleblower rules do not address whether the SEC may pay a related-action award when an eligible whistleblower voluntarily provides original information that leads to a deferred prosecution agreement (DPA) or non-prosecution agreement (NPA) entered into by the US Department of Justice or a state attorney general in a criminal proceeding. Under the proposed amendments, the SEC would be able to make award payments to whistleblowers based on money collected as a result of such DPAs and NPAs, as well as under settlement agreements entered into by the SEC outside of the context of a judicial or administrative proceeding to address violations of the securities laws.

- The proposed amendments would provide additional considerations for small and exceedingly large awards. For awards less than $2 million, the proposed amendments would authorize the SEC in its discretion to adjust the award percentage upward under certain circumstances (subject to the 30% statutory maximum) to an amount up to $2 million. For awards of at least $100 million, the proposed amendments would authorize the SEC in its discretion to adjust the award percentage so that it would yield a payout (subject to the 10% statutory minimum) that does not exceed an amount that is reasonably necessary to reward the whistleblower and to incentivize other similarly situated whistleblowers. However, in no event would the award be adjusted below $30 million.

- The proposed amendments would eliminate the potential for double recovery under the current definition of "related action" by preventing a whistleblower from receiving multiple recoveries for the same information from different whistleblower programs.

The amendments also propose a uniform definition of "whistleblower" that would apply to all aspects of Section 21F of the Exchange Act, including the reward program, the heightened confidentiality requirements and the employment anti-retaliation protections. The SEC would confer whistleblower status only on (i) an individual (ii) who provides the SEC with information "in writing" and only if (iii) "the information relates to a possible violation of the federal securities laws (including any law, rule, or regulation subject to the jurisdiction of the SEC) that has occurred, is ongoing, or is about to occur."

The proposed amendments also include changes related to increased efficiency in the claims review process, clarification and enhancements of certain policies and procedures and interpretive guidance on

[4] The full text of the proposed rule is available here.

certain defined terms within Section 21F of the Exchange Act. With the publication of the proposed rule, interested parties will have 60 days from the publication of the proposed rule in the Federal Register to provide comments to the proposal. Instructions for how to submit comments are provided in detail in the release describing the proposed amendments.

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