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Public Company Advisory Group Quarterly – Summer 2024

July 2024

We are pleased to bring you our inaugural edition of Public Company Advisory Group Quarterly, a concise summary of the latest developments of interest to public companies. In this edition, we cover Securities and Exchange Commission (SEC) and stock exchange rulemaking and disclosure updates, SEC statements, and other topics of interest to our public company clients.

SEC DISCLOSURE UPDATES

New Cybersecurity C&DIs

On June 24, 2024, the SEC added five new Form 8-K Compliance & Disclosure Interpretations (C&DIs) covering Item 1.05 (Material Cybersecurity Incidents) of Form 8-K.[1] Pursuant to the SEC's September 2023 rules[2] requiring disclosure of cybersecurity processes and cybersecurity incidents (which are summarized in our Reference Guide), public companies are required to, among other things, report material cybersecurity incidents under Item 1.05 of Form 8-K within four business days after making the determination that any such cybersecurity incident it has experienced is material.

The new C&DIs, which are summarized below, generally reiterate that a registrant is required to make a materiality determination with respect to a cybersecurity incident and to file an Item 1.05 Form 8-K to disclose any cybersecurity incident that it has determined to be material, regardless of cessation of the attack, payment of ransomware, availability of cyber insurance, or other factors.

While many of the C&DIs focus on cybersecurity incidents that involve ransomware payments, the underlying guidance in the C&DIs applies broadly to all types of cybersecurity incidents.

Question 104B.05: Registrants should conduct a materiality assessment and make a materiality determination with respect to a cybersecurity incident notwithstanding the fact that the incident may have already been resolved. Further, a registrant can't necessarily conclude that an incident is not material simply because the incident has ceased or apparently ceased prior to the materiality determination, including as a result of the registrant making a ransomware payment.

Question 104B.06: If a registrant experiences a cybersecurity incident and determines it to be material, the subsequent cessation or apparent cessation of the incident before the Form 8-K filing deadline does not relieve the company of its obligation to disclose the incident on Item 1.05 of Form 8-K.

Question 104B.07: A cybersecurity incident involving a ransomware attack may still be material even if the registrant has an insurance policy that covers cybersecurity incidents and is reimbursed for all or a substantial portion of the ransomware payment made to the threat actor. In making a materiality determination, a registrant should consider all relevant facts and circumstances, which may be both quantitative and qualitative, including the effects on the registrant's operations, finances, brand perception and customer relationships. Additionally, the subsequent availability of, or increase in cost to the registrant of, insurance policies that cover cybersecurity incidents may factor into the registrant's consideration of qualitative and quantitative factors to determine the materiality of the cybersecurity incident.

Question 104B.08: The size of a ransomware payment, if any, made in connection with a cybersecurity incident is only one of the facts and circumstances that a registrant should consider in making its materiality determination regarding the cybersecurity incident and is not determinative as to whether the cybersecurity incident is material.

Question 104B.09: Because the definition of "cybersecurity incident" that applies to Item 1.05 of Form 8-K includes "a series of related unauthorized occurrences," a registrant that has experienced a series of immaterial cybersecurity incidents, should consider whether any of those incidents were related, and if so, determine whether those related incidents, collectively, were material.

Other Disclosure Updates

Compliance Dates for SEC Rule Regarding Insider Trading Arrangements and Related Disclosures

Companies are now required to comply with the SEC's new insider trading disclosure requirements in their Annual Reports on Form 10-K. The requirements, which were adopted by the SEC in December 2022,[3] require registrants to:

- Disclose in Item 10 of Part III of their Annual Report on Form 10-K whether they have adopted insider trading policies and procedures that are "reasonably designed to promote compliance" by directors, officers and employees, as well as by the company, with applicable insider trading laws, rules, and regulations, and if not, to explain why they have not done so;[4] and
- File their insider trading policies and procedures (if any) as Exhibit 19 to their Annual Report on Form 10-K.[5]

While most insider trading policies govern trading only by the company's employees and other insiders, and not the company itself, the new Part III, Item 10 disclosure also requires a company to disclose whether it has policies and procedures governing purchases by the company itself or explain why it has not done so.

The first disclosures under these new rules are required in the Annual Report covering the first full fiscal year that begins on or after April 1, 2023–which means most filers should now plan to comply with these requirements in their next-filed Form 10-K, although the disclosure required by Part III, Item 10 may be incorporated by reference to a company's annual proxy statement if it is filed within 120 days of the end of their fiscal year end as permitted by Instruction G.3 of Form 10-K. Companies with fiscal years ending April 1, 2024 and later should have already begun complying with the requirements beginning with their most recently-filed Form 10-K.

New Reporting Deadlines for Schedule 13G Filings Effective on September 30, 2024

Starting on September 30, 2024, Schedule 13G filers will need to comply with shortened filing deadlines under the SEC's October 2023 beneficial reporting rules (the Beneficial Reporting Rule). Updates to Schedule 13D filing deadlines made by the Beneficial Reporting Rule, which accelerated the initial filing deadline to within five business days (vs. ten calendar days) after exceeding 5% beneficial ownership and require amendments of material changes to be filed within two business days, became effective on February 5, 2024.

Initial Schedule 13G Filing Deadlines

Qualified Institutional Investors (QIIs)[6] / Exempt Investors[7]	QIIs	Passive Investors[8]
45 days after calendar quarter-end (reduced from 45 day after calendar year end) in which beneficial ownership exceeds 5%	Five business days (reduced from 10 days) after month-end in which beneficial ownership exceeds 10%	Five business days (reduced from 10 days) after acquiring beneficial ownership of more than 5%

Schedule 13G Amendment Filings Triggers and Deadlines

All Schedule 13G Filers	QIIs	Passive Investors
45 days after calendar quarter-end in which a material change in information reported in previously filed Schedule 13G occurred (reduced from 45 days after calendar year in which any change occurred)	Five business days (reduced from 10 days) after month-end in which beneficial ownership exceeds 10% or increases or decreases by 5%	Two business days (changed from "promptly") after beneficial ownership exceeds 10% or increases or decreases by 5%

SEC RULEMAKING UPDATES

The following items describe the status of various proposed and final rules that are most relevant to public companies.

SEC Voluntarily Stays Climate Disclosure Rule

On April 4, 2024, the SEC voluntarily stayed implementation of its rule imposing climate-related disclosure requirements on public companies (the Climate Rule) pending completion of the ongoing litigation challenging the SEC's authority to adopt the Climate Rule.[9]

The Climate Rule, which is discussed in our Client Alert, was adopted by the SEC on March 6, 2024 and immediately challenged in cases filed across six federal circuit courts. These cases have been consolidated and transferred to the Eighth Circuit Court of Appeals. In its order issuing the stay, the SEC noted that it planned to vigorously defend the Climate Rule. Briefing in the litigation is underway and expected to be completed by September 17, 2024,[10] with oral arguments to follow thereafter.

The Climate Rule sets forth phase-in periods for climate reporting, with staggered starts for reports filed in 2026 and 2028 based on company filer status and disclosure category. However, because the SEC stayed the Climate Rule before its effective date, the Climate Rule will not become effective while the stay is pending and the SEC has indicated that it will address new effective dates for the Climate Rule at the conclusion of the stay.[11]

Technical Amendment to Reflect Vacatur of Share Repurchase Rule

On April 8, 2024, the SEC adopted technical amendments[12] to reflect the Fifth Circuit Court of Appeals vacatur[13] of amendments to Item 703 of Regulation S-K (the Share Repurchase Rule), which would have required issuers to provide additional disclosures about repurchases of their equity securities. The technical amendments restore Item 703 of Regulation S-K and other pre-Share Repurchase Rule rules and forms to remove the changes made by the Share Repurchase Rule. In Form 10-Qs, this includes adjusting the heading of Part II, Item 2 to remove the reference to "Issuer Purchases of Equity Securities."

SELF-REGULATORY ORGANIZATION RULEMAKING UPDATES

New York Stock Exchange (NYSE)

New Rule Allows NYSE to Delist Companies That Change Their Primary Business Focus After Listing

On July 24, 2024, the SEC approved an amendment to Section 802.01 (Continued Listing Criteria) of the NYSE Listed Company Manual to allow the NYSE to suspend and delist a listed company that has changed its primary business focus "to a new area of business that is substantially different from the business it was engaged in at the time of its original listing or which was immaterial to its operations at the time of its original listing."[14]

Any company that makes such a change to its primary business focus must promptly notify the NYSE in writing of such change. The NYSE will then assess the company's continued suitability for listing, specifically considering whether it would have accepted the listed company for initial listing if it had been engaged in the modified business at the time of the original listing. The NYSE will consider the new business focus and also any other changes that may have occurred in connection with the company's change in business focus, such as changes in the company's governance, voting power, ownership, and financial structure.

While the NYSE has not defined what it means for a company to change its primary business focus, the NYSE has stated that it expects that a decision to suspend and delist a company under these circumstances would be an "extraordinary action" that it will seldom rely on.[15]

New Rule Requiring Trading Halt in Event of Reverse Stock Split

On April 17, 2024, the NYSE amended Rule 123D (Halts in Trading) to require the NYSE to halt trading in a security at the end of trading on the day immediately before the market effective date of a reverse stock split (the Effective Date), followed by a delayed opening of the security on the Effective Date.[16]

The amendment addresses concerns with the NYSE's practice of processing reverse stock splits overnight and harmonizes NYSE rules with Nasdaq Rule 4120(a)(14), which was amended effective November 2023, and similarly

halts trading of a security before 8:00 pm Eastern Time on the day immediately before the market effective date of a reverse stock split, with trading generally expected to resume at 9:00 am on the day the split is effective.

In its adopting release, the NYSE noted that it believed the new rule would minimize the chance that market participants might make erroneous trades in a security because they were unaware that it had undergone a reverse stock split.

The Nasdaq Stock Market, LLC (Nasdaq)

Fifth Circuit Hears Legal Challenges to Nasdaq Board Diversity Rule

On May 14, 2024, the full Fifth Circuit Court of Appeals heard oral arguments in a case challenging the SEC's approval of Nasdaq Listing Rule 5605(f), which sets forth board diversity objectives for Nasdaq-listed companies (and requires companies to disclose their reasons for failing to comply with the objectives), and Nasdaq Listing Rule 5606(a), which mandates annual disclosure of a company's board diversity statistics on a standardized template (collectively, the Board Diversity Rule). A three-judge panel of the Fifth Circuit previously found that the SEC acted appropriately when it approved the Board Diversity Rule.[17]

The court's opinion is forthcoming. On July 18, 2024, the court requested supplemental briefing on specific questions relating to a service provided by Nasdaq to allow boards to access diverse candidates, with briefs submitted by both parties on July 25, 2024.[18]

Notwithstanding the pending litigation, parts of the Board Diversity Rule, including the tabular disclosure requirement and the first phase of the director diversity objective, have already gone into effect.

SEC STATEMENTS

SEC Officals Speak on Complying with the Cybersecurity Rule

On April 4, 2024, Luna Bloom, the SEC's Chief of the Office of Rulemaking Advice, and Nabeel Cheema, SEC special counsel, spoke to attendees of the International Association of Privacy Professionals (IAPP) Global Privacy Summit held in Washington, DC on how companies should conduct materiality determinations with respect to cybersecurity incidents for purposes of disclosure on Item 1.05 of Form 8-K.[19]

Ms. Bloom and Mr. Cheema noted that companies should review the materiality of cybersecurity incidents using the same "reasonable investor" standard and disclosure procedures and practices applicable to other corporate events. Under this standard, materiality of a cybersecurity incident is determined based on "what a reasonable investor would consider important in making investment decisions" after consideration of both quantitative factors, such as financial impacts, and qualitative factors, such as harm to reputation or relationships. Mr. Cheema noted that whether a cybersecurity incident would be considered material for SEC disclosure purposes could differ from what cybersecurity professionals might consider material.

Mr. Cheema also reminded participants that the materiality determination with respect to a cybersecurity incident must be made "without unreasonable delay." In complying with this standard, companies should avoid "gamesmanship with materiality"—for example, postponing meetings to delay discussing an incident—and adhere to existing procedures.

Corp Fin Statements Clarifying Aspects of the SEC's Rule Requiring Disclosures of Cybersecurity Incidents

On May 21, 2024 and June 20, 2024, Erik Gerding, the Director of the SEC's Division of Corporation Finance, made statements clarifying his views on certain aspects of the SEC's rules requiring disclosure of material cybersecurity incidents on Item 1.05 of Form 8-K.

As discussed in our Client Alert, Mr. Gerding's first statement encouraged companies to limit their disclosure of cybersecurity incidents under Item 1.05 of Form 8 K to those cybersecurity incidents that have been "determined by the registrant to be material." Though not strictly required, he encouraged registrants to disclose under a different item of Form 8-K (e.g., Item 8.01) any cybersecurity incident that it wishes to disclose (i) that it has determined is not material, or (ii) for which it has not yet made a materiality determination.

In his June 2024 statement, Mr. Gerding acknowledged that sharing information about a material cybersecurity incident (including information beyond which was disclosed in Item 1.05 of Form 8-K) with commercial counterparties and other potentially impacted companies could assist with remediation, mitigation, and risk avoidance, and clarified that such information sharing was not prohibited by the cybersecurity rules. Further, Mr. Gerding reassured registrants that they could freely share such information as long as it is done in a Regulation FD-compliant manner, for example, by stating that the information is immaterial, by sharing the information only with parties that are

not members of the investment community covered by Regulation FD, or by making the communication confidentially.

Corp Fin Statement on Disclosure Review Priorities

On June 24, 2024, Erik Gerding released a statement highlighting the SEC's Division of Corporation Finance's disclosure priorities for 2024. The statement was based on remarks and discussions made by Mr. Gerding and other SEC officials during the 2024 SEC Speaks Conference held on April 2, 2024. The priorities identified by Mr. Gerding include:

- **China-based companies.** Mr. Gerding noted that the SEC staff will continue to focus on disclosure issues addressed in the SEC's December 2021 Sample Letter to China-Based Companies and July 2023 Sample Letter to Companies Regarding China-Specific Disclosures, "including those related to the variable interest entity (VIE) structure, the reliability of financial reporting, the regulatory environment in China, and corporate governance matters."

- **Inflation.** Mr. Gerding cautioned against "reverti[ing] to boilerplate disclosure" on inflation and stated that registrants should continue to discuss the material ongoing "particularized risks and impacts" posed by inflation on their specific company.

- **Interest rate and liquidity risk.** Mr. Gerding stated that the SEC staff will continue to "take a close look at updated disclosures related to interest rate risk and liquidity risk" following recent disruptions in the banking industry.

- **Artificial intelligence (AI).** Mr. Gerding warned that the use of AI in business operations exposes registrants to operational and business risks that could require disclosure in multiple sections of their Annual Report (e.g., risk factors, description of business, MD&A, financial statements, and the discussion of the board's role in risk oversight). When reviewing AI disclosures, the SEC will consider, to the extent material, whether or not a company:

  - clearly defines what it means by AI and how it uses AI to improve its financial results and future prospects;
  - provides particularized disclosure of material risks and the impact AI is reasonably likely to have on its business and financial results;
  - focuses on its actual current or proposed use of AI, rather than "buzz words not related to its business"; and
  - has a reasonable basis for its claims when discussing AI prospects.

- **Commercial real estate (CRE) exposure.** According to Mr. Gerding, the SEC staff has been focusing on certain aspects of CRE exposure for banks and REITs that are subject to CRE risks. For banks, the SEC staff will consider how the banks are disclosing disaggregation of loan portfolio characteristics, geographic and other concentrations, loan-to-value ratios, loan modifications, nonaccrual loan policies, policies around timing, frequency and sources of appraisals, and risk management. For REITs, the SEC will consider how office and retail REITs are describing default risks or liquidity issues and any mitigating efforts, debt maturity and lease term schedules, trends in lease renewals, major tenant rollovers, financial viability of tenants, property dispositions, asset impairments, and tenant receivables.

- **Recently adopted rules.** Mr. Gerding stated that the SEC staff will review disclosures made pursuant to certain recently adopted SEC rules—including the SEC's recently adopted rules covering beneficial ownership reporting, cybersecurity disclosures, clawback policies, universal proxy, and pay versus performance disclosures—to assess compliance, provide guidance, and improve disclosures for investors. With respect to pay versus performance, Mr. Gerding noted that the SEC staff is utilizing machine-readable data to make preliminary assessments of compliance with the rules.

Shadow Trading: Updates to Insider Trading Policies Following *Panuwat* Verdict

As discussed in our Client Alert, on April 9, 2024 a jury in the US District Court for the Northern District of California found pharmaceutical company executive Matthew Panuwat guilty of insider trading in the first case brought under a novel application of the misappropriation theory of insider trading known as "shadow trading." Mr. Panuwat has appealed the verdict and is seeking a new trial.

The misappropriation theory of insider trading involves trading on the basis of material nonpublic information in breach of a duty, arising from a relationship of trust and confidence, owed to the source of the information. Traditionally, cases are brought when the insider purchases securities in the same company about which the material nonpublic information relates. Under the shadow trading theory, an insider could also be liable for insider trading when (i) the insider obtains nonpublic information through their relationship with a company in which the insider owes a duty, such as through an employment or similar relationship (Company A), (ii) the information is material to another company (Company B) or its securities and (iii) the insider uses the information to buy or sell securities in Company B.

The SEC, in its statement following the jury verdict, said that "there was nothing novel about this matter, and the jury agreed: this was insider trading, pure and simple." In light of the verdict and the SEC's subsequent statements, companies should consider addressing shadow trading in their insider trading policies to ensure that employees are adequately informed of and protected against potential insider trading liability for shadow trading.

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1. The C&DIs are available at, https://www.sec.gov/rules-regulations/staff-guidance/compliance-disclosure-interpretations/exchange-act-form-8-k.
2. Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, Securities Act Release No. 11,216, Exchange Act Release No. 97,989, 88 Fed. Reg. 51896 (released July 26, 2023), https://www.sec.gov/files/rules/final/2023/33-11216.pdf.
3. Insider Trading Arrangements and Related Disclosures, Securities Act Release No. 11,138, Exchange Act Release No. 96,492, 87 Fed. Reg. 80362 (Dec. 29, 2022), https:/www.sec.gov/files/rules/final/2022/33-11138.pdf.
4. 17 C.F.R. § 229.408(b)(1).
5. 17 C.F.R. § 229.408(b)(2).
6. QIIs are certain institutional investors qualified to report on Schedule 13G, in lieu of Schedule 13D and in reliance upon Rule 13d-1(b). See 17 CFR 240.13d-1(b)(1)(ii).
7. "Exempt Investors" are persons holding beneficial ownership of more than 5% of a covered class of a company's securities, but who have not made an acquisition of beneficial ownership subject to Section 13(d) of the Exchange Act.
8. "Passive Investors" are beneficial owners of more than 5% but less than 20% of a covered class who can certify under Item 10 of Schedule 13G that the subject securities were not acquired and are not held for the purpose or effect of changing or influencing the control of the issuer of such securities and were not acquired in connection with or as a participant in any transaction having such purpose or effect.
9. Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11,280, Exchange Act Release No. 99,908 (April 4, 2024), https://www.sec.gov/files/rules/other/2024/33-11280.pdf.
10. Iowa v. SEC, No. 24-1522 (8th Cir. June 20, 2024) (order granting petitioner's motion to extend final brief deadline).
11. Respondent's Motion at 5 n.2, Iowa v. SEC (8th Cir. filed Apr. 5, 2024) (No. 24-1522).
12. Share Repurchase Disclosure Modernization, Exchange Act Release No. 99,778; Investment Company Act Release No. 35,157, 89 Fed. Reg. 24372 (Apr. 8, 2024), https://www.sec.gov/files/rules/final/2024/34-99778.pdf.
13. Chamber of Com. of the USA v. SEC, No. 23-60255 (5th Cir. Dec. 19, 2023) (order granting petitioner's motion to vacate the final rule).
14. Order Granting Approval of a Proposed Rule Change Concerning the Suspension and Delisting of a Listed Company that has Changed its Primary Business Focus, Exchange Act Release No. 100,585, 89 Fed. Reg. 61207 (released July 24, 2024), https://www.sec.gov/files/rules/sro/nyse/2024/34-100585.pdf.
15. *See* id. at 5.
16. Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Rule 123D, Exchange Act Release No. 99,974, 89 Fed. Reg. 30415 (released Apr. 17, 2024), https://www.sec.gov/files/rules/sro/nyse/2024/34-99974.pdf.
17. Alliance for Fair Board Recruitment v. SEC, No. 21-60626 (5th Cir. Oct. 18, 2023).
18. Alliance for Fair Board Recruitment v. SEC, No. 21-60626 (5th Cir. July. 18, 2024) (order requesting supplemental briefing).
19. Allison Grande, *SEC Officials Say Existing Policies Key to Cyber Rule Reports*, Law360 (Apr. 4, 2024, 10:10 PM), https://www.law360.com/articles/1821337/sec-officials-say-existing-policies-key-to-cyber-rule-reports.

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