

# Hard at Work Closing Out an Already Active 2018, SEC Adopts Hedging Rules, Extends Regulation A to all Public Companies and Solicits Comments on Earnings Releases and Quarterly Reports

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## SEC Adopts Rules for Public Companies to Use Regulation A

Keeping up with the commitment to promote capital formation,<sup>1</sup> on December 19, 2018, the Securities and Exchange Commission (“SEC”) adopted final rules<sup>2</sup> to allow publicly reporting companies to rely on the Regulation A (“Reg A”) exemption from registration for securities offerings of up to \$50 million in a 12-month period. Prior to this amendment, Reg A was available only to eligible<sup>3</sup> issuers not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act.

The final rules amend Securities Act Rule 251 to permit public companies to issue securities under this exemption. Further, Securities Act Rule 257(b), which requires compliance with certain periodic and current reporting obligations by issuers of a Tier 2 offering,<sup>4</sup> has been amended to enable Exchange Act reporting

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<sup>1</sup> See the “Economic Growth, Regulatory Relief and Consumer Protection Act” enacted in May 2018.

<sup>2</sup> Available [here](#).

<sup>3</sup> See Securities Act Rule 251(b).

<sup>4</sup> A Tier 2 Offering is defined in Securities Act Rule 251(a)(2) as an offering in which the sum of the aggregate offering price and aggregate sales does not exceed \$50 million including not more than \$15 million offered by all selling security holders that are affiliates of the issuer.

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companies to satisfy the ongoing reporting requirements of Rule 257(b) through compliance with the reporting requirements of the Exchange Act.

The revisions are designed to allow public companies more flexibility in structuring their capital-raising transactions. The amendments to Reg A will become effective upon publication in the *Federal Register*.

It is worth noting that the SEC did not amend the financial statement requirements of Form 1-A, which is filed in connection with a Reg A offering. While the financial statement requirements in a Reg A offering differ from the requirements for Exchange Act reports, they tend to be less burdensome. Exchange Act reporting companies may not incorporate their financial statements by reference into Form 1-A, and in light of the provisions of Rule 252, they may also need to include their most recent publicly available financial statements in order for the Reg A offering statement not to be misleading.

## SEC Adopts Hedging Policy Disclosure Rules

On December 18, 2018, the SEC adopted final rules<sup>5</sup> that require a reporting company to disclose in its proxy or information statement for the election of directors its practices or policies with respect to hedging of company securities by employees, officers or directors. Specifically, new Item 407(i) of Regulation S-K will require a company to describe any practices or policies it has adopted regarding the ability of its employees (including officers) or directors to purchase securities or other financial instruments, or otherwise engage in transactions, that hedge or offset, or are designed to hedge or offset, any decrease in the market value of equity securities granted as compensation, or held directly or indirectly by the employee or director. Equity securities include securities of the company, any parent of the company, any subsidiary of the company, or any subsidiary of any parent of the company.

To satisfy this requirement, a company can either provide a summary of its practices or policies, including the categories of persons they affect and any hedging transactions that are specifically permitted or specifically disallowed, or, alternatively, disclose the practices or policies in full. If a company does not have any such practices or policies, it must disclose that fact or state that hedging transactions are generally permitted. Companies are not required to adopt hedging policies or disclose any particular hedging transactions. The SEC did not define the types of hedging transactions covered by the new disclosure requirement; rather, all transactions that establish downside price protection are covered.

The final rules implement Section 14(j) of the Exchange Act, which was enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Companies generally must comply with the new disclosure requirements in proxy and information statements for the election of directors during fiscal years beginning on or after July 1, 2019. However, smaller reporting companies and emerging growth companies do not have to comply until fiscal years beginning on or after July 1, 2020. Investment companies registered under the Investment Company Act of 1940 (including closed-end funds) and foreign private issuers will not be subject to the new disclosure requirements.

## SEC Solicits Public Comment on Earnings Releases and Quarterly Reports

On December 18, 2018, the SEC published a request for comment<sup>6</sup> soliciting input on the nature, content and timing of earnings releases and quarterly reports made by reporting companies. Building on comments the SEC received in response to its 2016 concept release on the business and financial disclosure requirements of Regulation S-K,<sup>7</sup> the request for comment seeks input on how the SEC can reduce administrative and other burdens on reporting companies associated with quarterly reporting, while maintaining or enhancing appropriate investor protection. The SEC also requested comments on how the current reporting system and earnings

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<sup>5</sup> The SEC's press release is available [here](#).

<sup>6</sup> Available [here](#).

<sup>7</sup> Available [here](#).

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guidance practices affect corporate decision-making and strategic thinking. The request focuses on the following issues:

### **Information Content Resulting From the Quarterly Reporting Process:**

This section addresses the nature of disclosures that reporting companies must provide in their Form 10-Q reports, and voluntarily provide in earnings releases furnished on Form 8-K. More specifically, the request asks questions including:

- What are the benefits and drawbacks of both earnings releases and Form 10-Q reports? How do investors use quarterly disclosure and earnings guidance and are both necessary?
- Does quarterly earnings guidance create undue focus on short-term financial results and detract from companies' ability to focus on long-term results?

### **Timing of the Quarterly Reporting Process:**

The SEC is interested in the differences among companies' timing of earnings releases relative to filing the related Form 10-Qs. Specific questions include:

- Why do some companies publish an earnings release before filing Form 10-Q while others publish them simultaneously and should the SEC take any action to address the time lapses?
- Are investors and other market participants on earnings calls disadvantaged by not having the more detailed information in the 10-Q if a company publishes its earnings release first?

### **Earnings Release as Core Quarterly Disclosure:**

The SEC is exploring ways to alleviate burdens related to Form 10-Q reporting while maintaining appropriate investor protection. Comment is being sought on questions including:

- Should companies be permitted to supplement Form 8-K earnings releases to satisfy Form 10-Q disclosure requirements or, alternatively, to incorporate by reference Form 8-K earnings release disclosure in Form 10-Q?
- Would these approaches raise concerns regarding incorporation by reference into registration statements and the related liability under the federal securities laws?

### **Reporting Frequency:**

The SEC is considering whether to allow reporting companies, or certain classes thereof, flexibility in the frequency of their periodic reporting and how this would impact investors. Specific questions include:

- Does the frequency of reporting lead managers to focus on short-term results to the detriment of long-term performance? If so, does this negatively affect investors?
- What would the costs and benefits be to investors, companies, lenders and other market participants who rely on the current regulatory regime of moving to a semi-annual reporting model for all or certain categories of reporting companies or of allowing companies, additional flexibility to select their own approach to periodic reporting?
- How would these changes potentially affect: (i) the ability to compare results among companies, (ii) the cost of capital to companies, (iii) accounting and auditing requirements, and (iv) a company's ability to maintain current shelf registration statements?

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The request for comment indicates that the SEC is seeking to strike the appropriate balance between sufficient transparency, reducing regulatory burdens and encouraging a more long-term focus by companies. The public comment period will remain open for 90 days following publication in the *Federal Register*.

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