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SEC/CORPORATE

SEC Proposes Rule 144 Tacking Amendments

On December 22, 2020, the Securities and Exchange Commission voted to propose amendments to Rule 144 under the Securities Act of 1933 (the Securities Act) relating to tacking of holding periods for certain “market-adjustable securities.” Under the proposed rules, the Rule 144 holding period with respect to the underlying securities of these market-adjustable securities would not commence until such securities are acquired from the issuer upon conversion or exchange. The SEC also proposed amendments related to Form 144 filings, including mandating that such filings be made electronically.

Rule 144 Background

Generally, all offers and sales of securities in the United States must be registered with the SEC, unless an exemption from registration is available. Rule 144 provides a non-exclusive safe harbor for the resale of restricted securities (securities acquired directly from an issuer in an unregistered transaction) and is also applicable in the case of the resale of control securities (securities held by affiliates of the issuer). If a transaction satisfies the requirements of Rule 144, then the holder is not deemed a statutory “underwriter” and not engaged in a “distribution” within the meaning of the Securities Act and may resell the restricted securities, including in the public markets, without registration.

Among other requirements, under Rule 144, the holder of restricted securities must satisfy the minimum holding period required by Rule 144, which in the case of securities of a public reporting company is six months. The holding period requirement helps ensure that the holder has assumed the full economic risk of the investment and is not otherwise acting as a conduit for the issuer in selling securities to the public.

Importantly, Rule 144 provides for the “tacking” of the holding period in certain situations. In particular, Rule 144(d)(3)(ii) allows a holder to tack the holding period with respect to securities that were acquired from the issuer solely in exchange for other securities of the same issuer. Accordingly, in the case of convertible or exchangeable securities, the holding period with respect to shares acquired directly from the issuer upon conversion or exchange of securities of such issuer is deemed to have commenced upon the initial acquisition of the convertible or exchangeable security, not the later acquisition of the underlying security.

Proposed Amendments — Market-Adjustable Securities

The SEC’s proposed amendments provide that the holding period for securities acquired upon conversion or exchange of “market-adjustable securities” issued by unlisted issuers does not begin until the conversion or exchange, as opposed to upon the initial issuance of the market-adjustable securities as currently provided for in Rule 144(d)(3)(ii).

Unlike conventional convertible and exchangeable securities that typically convert or exchange based on a fixed price (subject to customary anti-dilution protections) and, thus, subject the holder to the economic risk based on the performance of the underlying security, market-adjustable securities do not contain a fixed conversion price. Instead, the holders have the right to convert at a conversion price based on the market price of the underlying securities at the time of conversion or exchange, and typically at a discount to such market price. Market-adjustable securities protect the holder against general decreases in the market value of the underlying securities.

As a result, the holder is not subject to the same economic risk of a decline in the market value of the underlying security as is a holder of a conventional convertible or exchangeable security with a fixed conversion price or exchange price. Such market-adjustable securities have been referred to as “death spiral” or “toxic” securities and, the SEC noted, tend to have been issued by a subpopulation of issuers, who are unable to issue conventional fixed rate securities due to being financially distressed, low revenue companies or approaching bankruptcy.

The proposed amendments would not allow tacking in the case of these market-adjustable securities only when:

- The underlying securities were acquired from an issuer that, at the time of the conversion or exchange, does not have a class of securities listed, or approved for listing, on a national securities exchange; and
- The securities contain terms, such as conversion rate or price adjustments, that offset, in whole or part, declines in the market value of the underlying securities occurring prior to conversion or exchange, other than customary adjustments for stock splits, dividends or other issuer-initiated changes in capitalization (but not price-based anti-dilution).

The SEC excluded securities of listed issuers from the proposed new rule on the grounds that such issuers are subject to stock exchange listing requirements, including rules requiring shareholder approval for issuances of 20 percent or more of the issuer’s common stock, that provide additional investor protections.

Other Proposed Amendments

An affiliate of an issuer selling securities in reliance on Rule 144 must file a notice of the sale on Form 144, if such affiliate intends to sell, during a three-month period, an amount exceeding 5,000 shares or securities with an aggregate sales price of more than $50,000. Currently, the Form 144 must be filed concurrently with the placing of a sales order with a broker or the execution of a sale directly with a market maker. For securities of issuers subject to the reporting requirements of the Securities Exchange Act of 1934 (the Exchange Act), the Form 144 may be filed either electronically through the SEC’s EDGAR system or in paper format. Historically, the vast majority of Form 144 filings have been made in paper format, limiting the ability of the public to review such filings without access to specialized reporting databases. Electronic filings, on the other hand, are more easily accessed through the SEC’s publicly available EDGAR system.

The SEC has proposed to (1) eliminate the Form 144 filing requirement with respect to securities of issuers that are not subject to the Exchange Act reporting requirements, (2) mandate that all Form 144 filings be submitted electronically through the SEC’s EDGAR system, and (3) amend the Form 144 filing deadline to be before the end of the second business day following the day on which the sale of the securities has been executed to align the Form 144 filing deadline with the existing Form 4 filing deadline.

Finally, the SEC has proposed to modify Forms 4 and 5, used for beneficial ownership reporting under Section 16 of the Exchange Act, to allow filers to indicate through a check box on the applicable form that the sale or purchase of securities reported on the form was made pursuant to a pre-arranged trading plan in compliance with Rule 10b5-1 of the Exchange Act. While many filers already disclose when transactions are made pursuant to a prearranged trading plan in a footnote to the filing, the check box is designed to provide a more efficient method for the disclosure.

The full text of the proposed amendments is available here.

SEC Again Approves NYSE’s Direct Listing Rules

On December 22, 2020, the Securities and Exchange Commission approved the New York Stock Exchange’s proposed new direct listing rules to allow companies engaging in a direct listing to raise capital directly through a primary sale of shares, in addition to, or instead of, only facilitating sales of shares by existing shareholders, as previously permitted.

These direct listing rules, originally approved by the SEC on August 26, 2020, were discussed in detail in the August 31, 2020 edition of the *Corporate & Financial Weekly Digest*. However, after initially approving the direct listing rules, on August 31, 2020, the SEC stayed implementation of the rules following receipt of a letter issued by the Council of Institutional Investors (CII) pursuant to which CII stated its intention to petition for a review of the direct listing rules. CII’s objections were previously discussed in the September 4, 2020 edition of the *Corporate & Financial Weekly Digest*.

Following CII's objection, the SEC conducted a de novo review of the direct listing proposal to determine whether the proposal was consistent with the Securities Exchange Act of 1934 (the Exchange Act) and the rules and regulations issued thereunder. The review found that the NYSE had met its burden to show that the proposed rule change was consistent with the Exchange Act, and, accordingly, the SEC approved the rules. In particular, the SEC noted that the proposal:

"will prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, will protect investors and the public interest; and will not permit unfair discrimination between customers, issuers, brokers, or dealers."

Under these new rules, the NYSE now recognizes two types of direct listings: (1) "Selling Shareholder Direct Floor Listings," where a company lists shares on the NYSE in connection with the direct sale of shares by existing shareholders (consistent with NYSE's prior rules); and (2) "Primary Direct Floor Listings," where a company lists shares on the NYSE and sells shares itself in the opening auction on the first day of trading, either in addition to, or instead of, facilitating shares by selling shareholders.

As a result of the new rules, companies will now have a path to go public without engaging in a traditional initial public offering process. Rather than hiring underwriters to sell shares to a group of investors, a direct listing allows a company to go public by facilitating the sale of shares directly into the market upon the effectiveness of a registration statement filed with the SEC.

Two Democratic commissioners, Allison Herren Lee and Caroline A. Crenshaw, dissented to the approval of the new direct listing rules, in part out of concern that investor protection will suffer by removing traditional underwriters from the listing process. They noted that "underwriters provide an important independent check on the quality of the registration statement" and are incented to do their job well because underwriters may face liability under Sections 11 and 12 of the Securities Act for misstatements or omissions by the issuer in the registration statement. Financial advisors involved in a direct listing process will not have the same liability concerns and may not provide investors the same level of protection, they argued. Further, Commissioners Lee and Crenshaw argued that allowing primary direct listings could exacerbate existing challenges investors face in recovering losses from false or misleading statements by issuers in public offerings because of "traceability," which is the legal doctrine requiring that investors be able to trace the shares they own to those actually sold by the issuer pursuant to the registration statement. In direct listings where issuers and selling shareholders are concurrently selling shares, and where, unlike in a traditional initial public offering (IPO), other investors may not be subject to lockup restrictions, the ability to trace shares back to an issuer, the dissenting commissioners argued, creates additional hurdles for investors seeking to bring claims against issuers for false or misleading statements.

On December 22, 2020, the Nasdaq Stock Market (Nasdaq) proposed updated rule changes to also facilitate primary direct listings that they described as "virtually identical" to that of the NYSE. The Staff of the Division of Trading and Markets of the SEC has indicated that it will expeditiously review the proposal, while accommodating a public comment process. However, given that Jay Clayton has resigned as chairman of the SEC, leaving only four commissioners (including two commissioners who opposed the expanded NYSE direct listing rules), and that the presidential administration is changing, it remains to be seen when, or whether, the Nasdaq proposal will be approved.

The full text of the SEC order approving the direct listing rules is available here.

A more fulsome description of the NYSE's direct listing rules is available in the August 31, 2020 edition of the *Corporate & Financial Weekly Digest*.

BROKER-DEALER

Elad Roisman Named Acting Chairman of SEC

On December 28, 2020, the Securities and Exchange Commission released a statement indicating that President Trump had chosen current Commissioner Elad L. Roisman as Acting Chairman of the SEC. Acting Commissioner

Roisman was first sworn in as a Commissioner of the SEC on September 11, 2018. Immediately prior, he served as Chief Counsel of the US Senate Committee on Banking, Housing, and Urban Affairs.

The SEC press release is available here.

SEC Announces New Internal Security-Based Swaps Joint Venture

On December 18, 2020, the Securities and Exchange Commission announced the creation of a joint venture among multiple SEC divisions and offices to coordinate roles related to the regulation of security-based swaps (SBS) and provide oversight of entities that will be required to register with the SEC (SBS entities). The SBS joint venture will be led by the Division of Examinations and the Division of Trading and Markets and will involve participation of staff from across the agency, including the Division of Enforcement, the Division of Economic Risk and Analysis, the Office of International Affairs and the Office of the Chief Data Officer.

In December 2019, the SEC adopted final rule amendments to effect a comprehensive SBS regulatory regime. As a result, beginning in November, SBS entities will be required to register with the SEC and be subject to certain regulatory requirements, including capital, margin and segregation. SBS entities will also have transaction reporting obligations. The SBS joint venture is intended to help position the SEC to effectively oversee the SBS market and monitor SBS transaction data for regulatory purposes.

The SEC press release is available here.

SEC Issues Statement on Custody of Digital Asset Securities by Special Purpose Broker-Dealers

On December 23, 2020, the Securities and Exchange Commission issued a statement and request for comment relating to custody of digital asset securities by broker-dealers, including certain conditional, time-limited relief for such arrangements. The statement will become effective 60 days after its publication in the Federal Register.

Most significantly, the SEC's statement indicates that, for a five-year period, a broker-dealer will not be subject to an SEC enforcement action on the basis that the broker-dealer has deemed itself to have obtained and maintained physical possession or control of customer fully paid and excess margin digital asset securities for the purposes of paragraph (b)(1) of SEC Rule 15c3-3 (the Customer Protection Rule), which requires such possession or control, *provided* that the broker-dealer operates in compliance with the circumstances outlined in the SEC's statement. Among other things, those circumstances require that the broker-dealer must limit its business to digital asset securities, implement policies and procedures reasonably designed to mitigate risks associated with its digital asset securities business, and provide customers with certain disclosures regarding risks of digital asset securities transactions.

The SEC also requested comment on a list of specific questions with respect to industry standards and best practices regarding custody of digital asset securities. Comments may be submitted electronically or in paper form.

The full statement and request for comment is available here.

CFTC

CFTC Staff Provides Temporary Relief to Futures Commission Merchants Regarding Certain SOFR-Linked Investments

On January 4, the Commodity Futures Trading Commission's (CFTC) Market Participants Division (MPD) issued Staff Letter 21-02 providing temporary no-action relief to permit futures commission merchants (FCM) to invest customer funds in investments that have adjustable rates of interest that correlate closely with, or are determined solely by reference to, a benchmark of the Secured Overnight Financing Rate (SOFR), recognizing the increasing use of SOFR as an alternative reference rate to LIBOR in financial markets.

CFTC Regulation 1.25 provides that the adjustable rate of interest on permitted investments must be benchmarked to the Federal Funds target or effective rate, the prime rate, the three-month Treasury Bill rate, the one-month or three-month LIBOR rate, or the interest rate of any fixed rate instrument that is a permitted

investment. Staff Letter 21-02 states that MPD staff will not recommend enforcement action to the CFTC if an FCM invests customer funds in permitted investments that contain an adjustable rate of interest that is benchmarked to SOFR.

The no-action relief expires on December 31, 2022.

The press release and access to Staff Letter 21-02 are available here.

CFTC Provides Relief to DCOs from New Daily Reporting Requirements

The Division of Clearing and Risk (DCR) of the Commodity Futures Trading Commission (CFTC) has issued no-action relief to derivatives clearing organizations (DCOs) from the CFTC's recently adopted daily reporting requirements.

As background, the CFTC amended CFTC Rule 39.19 to require DCOs, among other things, to report daily initial margin, variation margin, cash flow, and position information on an individual customer account basis. The compliance date for these amended reporting requirements would have been January 27. However, DCR has provided no-action relief from the amended reporting requirements until January 27, 2022 to permit additional time for the CFTC and DCOs to address operational and technological issues.

The press release and access to Staff Letter 21-01 are available here.

CFTC and ESMA Sign Enhanced MOU Related to Certain Recognized Central Counterparties

On January 7, the Commodity Futures Trading Commission (CFTC) and the European Securities and Markets Authority (ESMA) announced the signing of an Enhanced Memorandum of Understanding (MOU) regarding cooperation and the exchange of information with respect to certain registered derivatives clearing organizations established in the United States that are central counterparties (CCPs) recognized by ESMA under the European Market Infrastructure Regulation. The MOU expresses the desire of ESMA and the CFTC for enhanced cooperation with respect to the larger US CCPs operating in the European Union with provisions that expand upon the collaboration set out in the 2016 CFTC-ESMA MOU related to recognized CCPs.

The press release and access to the MOU are available here.

NFA Issues Notice to Members Regarding Compliance Date for Swaps Proficiency Requirements

On January 5, the National Futures Association (NFA) issued Notice I-21-01, reminding member firms that the compliance date for NFA's Swaps Proficiency Requirements (Requirements) is January 31 (Compliance Date). As more fully discussed in the July 10, 2020 edition of the *Corporate & Financial Weekly Digest*, NFA Members with associated persons (AP) required to satisfy the Requirements must ensure that covered individuals are in compliance by the Compliance Date. Individuals who do not satisfy the Requirements by the Compliance Date will be unable to engage in swaps activities until they have done so. After the Compliance Date, any individual seeking to engage in swaps activity will need to satisfy the Requirements prior to being approved as a swap AP at an intermediary or acting as an AP at a swap dealer.

For complete details regarding who must fulfill the Requirements, Notice I-19-09 is available here.

Notice I-21-01 is available here.

UK DEVELOPMENTS

HMT Announces Open Access Regime for Exchange Traded Derivatives

On December 30, 2020, HM Treasury (HMT) announced that the open access regime for exchange-traded derivatives (ETDs) introduced by the Markets in Financial Instruments Regulation (MiFIR) will continue to apply in the United Kingdom following the end of the transition period on December 31, 2020. In the European Union, the open access regime will be delayed through amendments to MiFIR included in the European Union's CCP

Resolution & Recovery Regulation; as this regulation was not finalized before the end of the transition period, the delay does not form part of retained EU law in the United Kingdom.

The MiFIR open access regime is intended to encourage greater non-discriminatory access between unaffiliated trading venues and central counterparties (CCPs), with a view to promoting greater competition in trading and clearing services and breaking so-called “vertical silos,” where a trading venue requires its trades to be cleared at a CCP under common ownership. Following the end of the transition period, HMT will review the relevant legislation and assess the suitability of the ETD open access arrangements for UK domestic markets.

HMT’s announcement is available here.

FCA Publishes Statement on Use of TTP to Modify UK Derivatives Trading Obligation

On December 31, 2020, the UK’s Financial Conduct Authority (FCA) published a statement on the use of temporary transitional power (TTP) to modify the UK’s derivatives trading obligation (DTO). The TTP will be implemented on December 31, 2020 at 11:00 p.m. UK time (the Statement).

Recently, the United Kingdom implemented the G20 commitment to improve over-the-counter derivatives markets by onshoring the Markets in Financial Instruments Regulation (MiFIR) DTO under the EU Withdrawal Act. The UK DTO applies to the same classes of derivatives as the EU DTO.

The United Kingdom has agreed to a trade and cooperation agreement and the associated joint declaration on financial services regulatory cooperation, which will consider mutual equivalence between the United Kingdom and European Union. The aim is to prevent disruption for market participants and reduce costs for investors.

Without mutual equivalence, the FCA will use its TTP to modify applications of UK DTO that conflict with EU DTO. This is particularly relevant for EU firms with London branches.

Under this modification, firms that are subject to the UK DTO trading with or on behalf of EU clients (subject to EU DTO) will be able to transact those trades on EU venues providing that:

- reasonable steps have been taken to satisfy that the client does not have arrangements to execute the trade on a trading venue to which both the United Kingdom and European Union have granted equivalence; and
- the EU venue has the required regulatory status to conduct business in the European Union (for example, a Recognised Overseas Investment Exchange with the relevant temporary permission or someone who benefits from the Overseas Person Exclusion).

The use of TTP on UK DTO only applies to UK firms, EU firms using the United Kingdom’s temporary permissions regime, and branches of overseas firms in the United Kingdom. It does not apply to trades with non-EU clients, proprietary trading conducted, and trades between UK branches of EU firms. These trades remain subject to the UK DTO.

The FCA expect firms and other regulated persons to be capable of demonstrating that they are taking reasonable steps during the first quarter of 2021 to ensure compliance with the UK DTO.

The FCA will consider its use of TTP and decide whether market or regulatory developments warrant a review of its approach by March 31.

The Statement is available here.

EU DEVELOPMENTS

ESMA Publishes Consultation Paper on Impact of Algorithmic Trading

On December 18, 2020, the European Securities and Markets Authority (ESMA) published a consultation paper to assist the European Commission (Commission) in reviewing and producing a report on the impact of requirements relating to algorithmic trading, including high-frequency trading. After consulting ESMA, the Commission is

required to present the report to the European Parliament and Council of the European Union under the Markets in Financial Instruments Directive (MiFID II) (the Consultation Paper).

The key areas covered in the Consultation Paper by ESMA include:

- presenting an overall approach and quantitative analysis towards algorithmic trading and high frequency trading, specifically the authorization regime connected to these types of market participants;
- discussing organizational requirements for investment firms that engage in algorithmic trading, including high-frequency traders and trading venues that authorize algorithmic trading on their systems; and
- addressing other provisions that aim at better framing the activity of algorithmic and high-frequency traders (for example tick sizes and market making).

ESMA also discusses new issues that have recently emerged on EU markets, which are closely linked to algorithmic trading (for example deployment of mechanisms called speedbumps and the sequence of trade confirmation to individual participants by trading venues versus the public disclosure of such transactions).

The deadline for comments on the Consultation Paper is March 21. ESMA intends to use comments in preparation of its final report to the Commission by July.

The Consultation Paper is available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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