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December 20, 2022

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2022 :: December 2022 :: December 20, 2022

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## Securities Regulation Daily Wrap Up, MERGERS AND ACQUISITIONS —FY23 funding bill includes significant securities bills and new CFTC whistleblower support, (Dec. 20, 2022)

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The omnibus bill contains provisions on M&A brokers, the Holding Foreign Companies Accountable Act, index-linked annuities, and funding for the CFTC's whistleblower program.

The Senate Appropriations Committee and the House Appropriations Committee released the text of the long-awaited FY23 omnibus government funding bill late last night. The bill includes routine funding provisions for the SEC and the CFTC, but it also includes significant provisions covering a range of topics, including M&A brokers, the Holding Foreign Companies Accountable Act, index-linked annuities, and the CFTC's whistleblower program. The latest continuing resolution temporarily extended FY22 funding until December 23, 2022 (See H.R. 1437), which means that the Senate and the House must quickly coordinate passage of the Consolidated Appropriations Act, 2023 (H.R. 2617) so that the bill can reach President Biden's desk by the Friday deadline.

**SEC, CFTC funding.** If the FY23 appropriations omnibus is enacted, both the SEC and the CFTC would receive funding in the amounts they requested back in March 2022. The SEC would receive $2.149 billion, an increase over FY22, which puts the agency at just below the $2 billion mark.

A further breakdown of the SEC's FY23 funding indicates that the agency would get an $18.979 million earmark for its inspector general office. The SEC also would receive funding for lease replenishment for its Washington, D.C. headquarters ($57.4 million) and its San Francisco regional office ($3.4 million).

The CFTC, which despite its oversight of derivatives markets under the Dodd-Frank Act, is typically funded at much lower levels than the SEC. In FY23, the CFTC would receive funding of $365 million.

**M&A brokers.** Title V of Division AA of the FY23 appropriations bill would provide for a registration exemption for small business mergers and acquisitions brokers by amending Exchange Act Section 15(b) to add a new subsection (13). The M&A brokers legislation has been around for several Congresses and has undergone multiple re-writes, which brought the bill more into alignment with existing SEC guidance and ultimately led to the bill's inclusion in the FY23 appropriations bill. The underlying legislation, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act (S. 3391; H.R. 935), was sponsored by Sen. John Kennedy (R-La) and Rep. Bill Huizenga (R-Mich). The House version passed the House in May 2022 by a vote of 419-0. The FY 23 appropriations provision would be effective 90 days after enactment.

According to the definition of "M&A broker," such person must reasonably believe that: (1) upon consummation of the transaction, any person who acquires the securities/assets of an eligible privately-held company will control and actively manage the company; and (2) any person who is offered securities in exchange for the securities/assets of an eligible privately-held company will, before the transaction is consummated, receive or have reasonable access to, the company's most recent fiscal year-end financials, any related statement from the independent accountant (if the financials are audited), a balance sheet dated no more than 120 days before the offer date, and information about the business, its management, and any material loss contingencies.

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Moreover, “eligible privately held company” would mean a company with: (1) no securities registered or required to be registered under Exchange Act Section 12; and (2) EDBITDA less than $25 million and/or gross revenues less than $250 million. The Commission would have authority to alter the dollar amounts in the definition of “eligible privately-held company.” The dollar amounts also would have to be adjusted for inflation every five years after enactment.

The bill further contains a list of activities that would require registration as a broker-dealer because they are outside the scope of the proposed exemption. Non-exempt activities would include many of the sine qua non of a broker-dealer, such as maintaining custody of or transmitting funds or securities to be exchanged by parties to a transaction involving an eligible privately held company. Lastly, the bill would deny the exemption to any person who has been barred or suspended from associating with a broker-dealer under federal or state law or by a self-regulatory organization.

At the time the bill passed the House in 2022, Rep. Huizenga remarked on the need for the bill. “Small businesses need to grow and have to do a couple of different things to be successful. For some that means they need to consolidate; some may need to restructure and try to recover from the challenges that have been exacerbated by the pandemic or the economy or whatever it might be; and sometimes it may be a family succession plan that is happening within those small businesses,” said Rep. Huizenga, as the bill was debated for the third time since it was first introduced several Congresses ago. Representative Huizenga added that “[t]hese innovators, entrepreneurs, and risk takers are critical to our country’s economic growth and prosperity. We need to level the playing field that gives an unfair advantage to those Wall Street big guys” (See, Congressional Record, May 10, 2022, p. H4748).

**Shortened HFCA Act timeframe.** The Holding Foreign Companies Accountable (HFCA) Act (Pub. L. No. 116-222), enacted in December 2020, allowed for the SEC and PCAOB to delist foreign companies from U.S. exchanges if those companies’ home country audit regulators deny the PCAOB the ability to inspect their audit work papers. The enacted legislation established a three-year time frame for de-listings. Title III of Division AA of the FY23 appropriations bill would shorten the timeframe from three years to two years and, thus, function as a kind of expedited backstop in case the PCAOB is unable to maintain access to registered accounting firms in certain foreign countries.

In the years since the HFCA Act’s enactment, the SEC and PCAOB have adopted regulations to implement the provisions of the Act. In December 2022, the PCAOB announced that it had achieved a historic agreement with Chinese regulators that “secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong.”

Initially, there were questions about how aggressive the SEC and PCAOB should be in seeking to delist foreign companies, many of which are based in China. For example, a statement submitted to the House by Rep. Brad Sherman (D-Calif), expressed the view of Sen. Kennedy, one of the original sponsors of the bill, that the SEC should have discretion in implementing the bill’s trading ban provisions (See, Congressional Record, December 2, 2020, at H6033-H6034). Specifically, the Kennedy statement addressed how much of the audit must be done within the PCAOB’s jurisdiction. “[I]t is our expectation that the Commission will not prohibit trading in the securities of companies under this act, as long as not more than one third of a company’s total audit is performed by a firm beyond the reach of PCAOB inspections,” said the statement.

The bills underlying the FY23 appropriations legislation were sponsored by Rep. Brad Sherman (D-Calif) and Sen. Joh Kennedy (R-La) (See S. 2184; H.R. 6285). The Senate version passed the Senate by unanimous consent in June 2021.

**Index-linked annuities.** Title I of Division AA of the FY23 appropriations bill contains provisions for the registration of index-linked annuities. The underlying legislation, introduced during the first session of the 117th Congress, was sponsored by Sen. Tina Smith (D-Minn) and Rep. Alma Adams (D-NC) (See S. 3198; H.R. 4865) and had substantial bipartisan support.

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Feb 9, 2023 from VitalLaw™

The omnibus provision would require the SEC to establish a new form for the registration of index-linked annuities, which may also contain conditions the SEC deems appropriate. Also, the SEC could, under Exchange Act Rule 12h-7(e), require an issuer to take steps reasonably designed to ensure that a trading market for the securities does not develop and, unless barred by state law, require written notice to, and acceptance by, the issuer before any assignment or other transfer of the securities and reserving the right to refuse assignments or other transfers at any time on a non-discriminatory basis.

A “registered index-linked annuity” would be defined to mean an annuity: (1) that is deemed to be a security; (2) that is registered with the SEC under Securities Act Section 5; (3) that is issued by an insurance company that is subject to state regulation; (4) that is not issued by an investment company; and (5) whose returns are based on a specified benchmark index/rate (or a registered ETF tracker) and which may be subject to a market value adjustment in the event that amounts are withdrawn early.

**Political spending rules policy rider.** The FY23 appropriations bill also again includes a policy rider that bars the SEC from finalizing rules that would require public companies to make disclosures about corporate political donations. The policy rider has been a staple of appropriations legislation since at least the second Obama Administration, despite Democrats’ attempts to eliminate the rider in pre-omnibus versions of Financial Services and General Government appropriations bill. A key question going forward now that the upcoming 118th Congress will be divided between Republicans (House) and Democrats (Senate) is whether some members of Congress may attempt to include a future similar rider on environmental, social, and governance (ESG) to block implementation of or to invoke the Congressional Review Act to disapprove the anticipated final SEC regulations on climate risk disclosures. A CRA resolution likely could not overcome a presidential veto by President Biden, but Administrations sometimes accept contrary provisions in appropriations legislation in order to keep the government open.

**CFTC whistleblower program.** Title II of Division HH of the FY23 appropriations bill would allow the CFTC to transfer additional funds from the agency's Customer Protection Fund to a separate account at the Treasury Department for the purpose of supporting the functions of the CFTC's whistleblower program. Specifically, the CFTC could use these funds to fund administrative, programmatic, and personnel expenses of the Whistleblower Office and the Office of Customer Education and Outreach.

Previously, in June 2021, Congress sought to prop up the CFTC’s whistleblower program, which at the time faced a shortfall because of an expectation that the agency would soon grant a large whistleblower award that could deplete remaining funds. Under the 2021 legislation, the CFTC was permitted to transfer up to $10 million to Treasury. The FY23 appropriations bill provision would allow the CFTC to transfer an additional $10 million with all such funds transferred by the CFTC remaining available until October 1, 2024. The funding backstop as originally enacted was to end on October 1, 2022.

**ESG and the Electoral Count Act.** The January 6, 2021, insurrection posed a significant question for many public companies regarding whether to continue making political donations to candidates who refused to acknowledge the results of the November 2020 presidential election in which Joe Biden was elected president. Shortly after the insurrection, some companies suspended donations to some candidates while officers at some companies called for significant campaign finance reforms, but many companies resumed making political donations in the months since the initial shock of January 6, 2021.

Division P of the FY23 appropriations bill contains the Electoral Count Reform and Presidential Transition Improvement Act of 2022. The Act would clarify that the role of the President of the Senate (i.e., the vice president) while presiding over the joint session is limited to performing solely ministerial duties. In other words, the vice president would have no power to solely determine, accept, reject, or otherwise adjudicate or resolve disputes over the proper certificate of ascertainment of appointment of electors, the validity of electors, or the votes of electors.

Other provisions in the Act address certificates of ascertainment of appointment of electors from state executives (in most instances a state’s governor). Appeals related to certificates of ascertainment would be subject to hearing by a three-judge federal district court panel whose decision may be directly appealed to the U.S.

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Supreme Court. Court determinations of disputes would be conclusive in Congress. The appeals process is open to aggrieved candidates for president or vice president.

As noted above, the SEC will be unable to do much of anything to require public companies to disclose their political spending habits because Congress has once again included a policy rider barring the SEC from finalizing such rules. Legislation to require SEC disclosures on political spending, including spending related to the insurrection, seems equally unlikely given the need for bills to achieve cloture in the Senate and the practical realities of an upcoming divided Congress. It remains to be seen whether the Electoral Count Act, which will become law if the FY23 appropriations bill is enacted into law, will serve to provide cover to companies making donations to certain candidates or if it might embolden companies to be more circumspect about which candidates to whom they make donations given the clarity the Act should bring to future elections.

**Merger modernization provisions.** Division GG of the FY23 appropriations bill contains the Merger Filing Fee Modernization Act of 2022. The Act modifies premerger filing fee amounts and contains other provisions that require disclosures about subsidies by foreign adversaries. The latter provision on foreign subsidies would seek to expose potentially distorted competitive processes resulting from subsidized firms' ability to undermine competition post-acquisition.

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