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<sup>13</sup>FASB News Release, *FASB Issues New Guidance on Accounting for Credit Losses* (June 16, 2016), available at [http://www.fasb.org/cs/ContentServer?pagename=FASB%2FFASBContent\\_C%2FNewsPage&cid=1176168232900](http://www.fasb.org/cs/ContentServer?pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176168232900).

## SEC/SRO UPDATE: SEC ADOPTS INTERPRETIVE GUIDANCE ON PAY RATIO RULE; HEDGE FUND ADVISER CHARGED FOR INADEQUATE CONTROLS TO PREVENT INSIDER TRADING; SEC CHARGES FORMER AMAZON EMPLOYEE WITH INSIDER TRADING; HESTER PEIRCE AND ROBERT JACKSON NOMINATED TO FILL OPEN SEC COMMISSIONER POSITIONS

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### SEC Adopts Interpretive Guidance on Pay Ratio Rule

On September 21, the Securities and Exchange Commission (SEC) issued interpretive guidance<sup>1</sup> to assist companies with the pay ratio disclosure requirements mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pay Ratio Rule).

The Pay Ratio Rule, adopted in 2015, requires a registrant to disclose the ratio of the compensation of its principal executive officer to the median employee's compensation.<sup>2</sup> Under the Pay Ratio Rule, affected companies (registrants) must begin making pay ratio disclosures in early 2018.

The interpretive guidance:

- States the SEC's views on the use of reasonable estimates, assumptions and methodologies, and statistical sampling permitted by the Pay Ratio Rule;
- Clarifies that a company may use appropriate existing internal records, such as tax or payroll records, in determinations about the inclusion of non-U.S. employees and in identifying the median employee; *and*
- Provides guidance as to when a company may use widely recognized tests (such as the IRS guidance with respect to independent contractors) to determine whether its workers are "employees" for purposes of the rule.

The SEC's Division of Corporation Finance staff simultaneously provided separate guidance about the Pay Ratio Rule. The staff's guidance focused on Item 402(u) of Regulation S-K, which sets forth the disclosure requirements and provides registrants with some flexibility in determining the pay ratio. For example, Instruction 4.1 to Item 402(u) provides that registrants may use reasonable estimates both in the methodology used to identify the median employee and in calculating the annual total compensation or any elements of total compensation for employees. Additionally, Instruction 4.2 to Item 402(u) permits a registrant to use its employee population or "statistical sampling" and/or "other reasonable methods" in determining the median employee. Through guidance and related hypothetical examples, the Staff sought to assist registrants in determining how to use such statistical

sampling methodologies and other reasonable methods.

### **Hedge Fund Adviser Charged for Inadequate Controls to Prevent Insider Trading**

On August 21, the SEC announced that a hedge fund advisory firm agreed to pay more than \$4.6 million to settle charges that it “failed to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of inside information, including information about confidential government decisions.”<sup>3</sup>

The case related to other insider trading charges recently filed by the SEC against current and former analysts at the adviser, a political intelligence analyst who passed them information, and an employee at the Centers for Medicare and Medicaid Services (CMS).

According to the SEC’s order, the firm conducted extensive research in the health care sector to help inform its investment decisions, and engaged research firms specializing in political intelligence about upcoming regulatory and legislative decisions. In addition, the adviser’s policies and procedures required an initial review of the research firms’ own policies and procedures, but the employees were otherwise left to police themselves by identifying issues and informing supervisors, as appropriate.

The order found that the adviser was “on notice” that the political intelligence analyst might be conveying material, nonpublic information to the analyst. For example, an email from the analyst said that he “heard from a reliable cms source” that CMS was about to issue a regulation, and an internal email noted that the analyst “has a guy” at a “closed-door” government meeting. The SEC alleged that from at least May 2012 to November 2013, the firm generated more than \$3.9 million in trading profits based on material, nonpublic information from the political intelligence analyst. The order also stated that through the adviser’s management agreements with the hedge funds, including

performance-based compensation, the adviser received approximately \$714,110 due to these trades.

Without admitting or denying the findings, the firm consented to the SEC’s order finding that it violated Section 204A of the Investment Advisers Act of 1940 by failing to establish, maintain and enforce policies and procedures reasonably designed to prevent the misuse of material, nonpublic information. The firm was also censured and required to pay disgorgement of slightly less than \$715,000 plus interest, and pay a penalty of slightly less than \$4 million.

### **SEC Charges Former Amazon Employee with Insider Trading**

On September 7, the SEC announced insider trading charges against a former Amazon financial analyst.<sup>4</sup> According to the SEC complaint,<sup>5</sup> in April 2015, in exchange for \$10,000, the former analyst allegedly gave his former fraternity brother confidential information about Amazon’s first quarter earnings just days before the information became public. The former fraternity brother, along with his trading partner, allegedly used that information to buy 4,400 shares of Amazon for \$1.715 million on the morning of April 23, 2015. Immediately after Amazon publicly released its 2015 first quarter earnings numbers that afternoon, its stock rose approximately 14% to \$445.10 per share, allowing the former fraternity brother and his trading partner to make approximately \$114,000 in profits. The former fraternity brother and his trading partner were also charged with insider trading in the SEC’s complaint.

According to the SEC’s complaint, just days before the company’s earnings announcement, the former fraternity brother posted on a social media site and stock-trading message board that he was predicting first quarter revenue of \$22.7 billion and earnings per share (EPS) of  $-\$0.12$ , which according to the complaint, were better than Wall Street predictions of \$22.4 billion in revenue and  $-\$0.14$  EPS. On the internet platforms where the former fraternity brother

posted his predicted revenue and EPS numbers, he wrote that the “numbers are so obvious” that a “5-year-old can guess what they will do.”

The former employee and the former fraternity brother’s trading partner agreed to settlements that remain subject to court approval. Without admitting or denying the allegations, the trading partner agreed to pay a penalty of \$11,599.74 and disgorgement of \$11,599.74, plus \$1,035.39 in interest for a total of \$24,214.87. The former employee agreed to pay disgorgement of \$10,000 plus interest of \$875.36 for a total of \$10,875.36.

According to the SEC press release, in a parallel action, the U.S. Attorney’s Office for the Western District of Washington is also bringing criminal charges against the former Amazon employee.

### Hester Peirce and Robert Jackson Nominated to Fill Open SEC Commissioner Positions

Two Commissioner vacancies at the SEC are likely to be filled in the near term, pending confirmation by the U.S. Senate. On July 19, the White House nominated Hester Maria Peirce, a Republican, and a professor at George Mason University, to fill one of two open Commissioner seats on the SEC.<sup>6</sup> Subsequently, on September 5, the White House nominated Columbia University Law Professor Robert Jackson, a Democrat, to fill the remaining open Commissioner vacancy.<sup>7</sup>

Peirce, a former Senate Banking Committee staff member, would replace former SEC Commissioner Luis Aguilar. If confirmed, Peirce would serve a partial term expiring on June 5, 2020. Peirce currently serves on the Investor Advisory Committee, which advises the SEC, and formerly served as an SEC staff attorney and as counsel to former Commissioner Paul S. Atkins. Peirce earned her BA in economics from Case Western Reserve University and her JD from Yale Law School.<sup>8</sup> During 2016, Peirce was nominated

to the SEC by President Barack Obama, but the full Senate did not act on her nomination.

Jackson, formerly a senior advisor at the Treasury Department, would fill the remaining open seat at the SEC, with a partial term expiring June 5, 2019. Jackson holds two bachelor’s degrees from the University of Pennsylvania, an MBA in finance from the Wharton School of Business, a master’s degree from Harvard’s Kennedy School of Government, and a law degree from Harvard Law School.<sup>9</sup>

Assuming both Peirce and Jackson are confirmed by the Senate, the Commission would again be at full strength with five Commissioners, consisting of two Republican Commissioners, two Democratic Commissioners, and current Republican Chairman Jay Clayton. The other Republican Commissioner is Michael Piwowar, whose term expires in 2018. The other, and currently only, Democrat Commissioner is Kara Stein, whose term expired on June 5, but Commissioners can stay on up to 18 months after their term expires.

### ENDNOTES:

<sup>1</sup>See SEC Press Rel. No. 2017-172 (Sept. 21, 2017), available at <https://www.sec.gov/news/press-release/2017-172>. See also SEC Rel. No. 33-10415 (Sept. 21, 2017), available at <https://www.sec.gov/rules/interp/2017/33-10415.pdf> (Interpretive Guidance) and “Division of Corporation Finance Guidance on Calculation of Pay Ratio Disclosure,” available at <https://www.sec.gov/corpfin/announcement/guidance-e-calculation-pay-ratio-disclosure> (Staff Guidance).

<sup>2</sup>See Pay Ratio Disclosure, SEC Rel. No. 33-9877 (Aug. 5, 2015), available at <https://www.sec.gov/rules/final/2015/33-9877.pdf>.

<sup>3</sup>See SEC Press Rel. No. 2017-146 (Aug. 21, 2017), available at <https://www.sec.gov/news/press-release/2017-146>. See also SEC Rel. No. IA-4749 (Aug. 21, 2017), available at <http://www.sec.gov/litigation/admin/2017/ia-4749.pdf> (SEC order).

<sup>4</sup>See SEC Press Rel. No. 2017-160 (Sept. 7, 2017), available at <https://www.sec.gov/news/press-release/>

2017-160.

<sup>5</sup>See *SEC v. Kennedy et al.*, (NO. 2:17-CV-01344) (U.S. District Court West. Dist. of Washington Seattle Division, September 7, 2017) available at <https://www.sec.gov/litigation/complaints/2017/comp-pr2017-160.pdf>.

<sup>6</sup>See White House Press Released (July 19, 2017) available at <https://www.whitehouse.gov/the-press-office/2017/07/19/eighteen-nominations-and-two-withdrawals-sent-senate-today>.

<sup>7</sup>See White House Press Released (Sept. 5, 2017) available at <https://www.whitehouse.gov/the-press-office/2017/09/05/forty-six-nominations-sent-senate-today>.

<sup>8</sup>See Hester Peirce Mercatus Center George Mason University bio at <https://www.mercatus.org/hester-peirce>.

<sup>9</sup>See Robert Jackson Columbia Law School bio at <http://www.law.columbia.edu/faculty/robert-jackson>.