October 3, 2023

SEC Charges Corporate Insiders and Public Companies for Failing to Timely Report Transactions and Holdings

Part of SEC's Ongoing Investigation of Late Insider Filings

SUMMARY

On September 27, 2023, the U.S. Securities and Exchange Commission ("SEC") announced charges against six public company insiders for failing to timely report information about their holdings and transactions in company securities. Five publicly traded companies were also charged with contributing to the filing failures by insiders or failing to report their insiders' filing delinquencies.[1] The SEC imposed fines for these violations ranging from $66,000 to $200,000. In connection with these actions, the SEC stated that, even where the issuer has assumed responsibility for reporting insider transactions, insiders are ultimately responsible for compliance with the disclosure requirements. However, where companies take on that responsibility, companies will also be held responsible for violations when they have acted negligently. In light of these actions, issuers should review and, if necessary, enhance their disclosure controls and procedures regarding insider holdings and transactions.

In three of the actions, the SEC charged violations of the reporting requirements under Sections 13(d) and 13(g) of the Securities Exchange Act of 1934. In these actions, the SEC alleged that greater than 5% shareholders failed to timely file and amend Schedules 13D and 13G.

BACKGROUND

Under Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), executive officers, directors, and greater than 10% beneficial owners of a registered class of a company's voting equity securities must file a Form 4 to report their non-exempt transactions in company equity and derivative securities within two business days. Transactions exempt from the two-business-day reporting requirement, or transactions required to be reported that have not been timely reported, must be reported on a Form 5 within 45 days after year-end.

The SEC requires late Section 16(a) reports to be reported in proxy statements pursuant to Item 405 of Regulation S-K. Item 405 requires, among other information, disclosure of the number of late reports and transactions included in those reports. Many issuers include in their annual director and officer questionnaires a confirmation that the director or the executive officer has timely made all Section 16 filings.

It is a common practice for issuers to make required filings under Section 16 for their executive officers and directors. Issuers utilize various policies and procedures to ensure these filings are made correctly and in a timely manner – from pre-clearance of trading to requiring trades to be made through designated brokers who have agreed to notify the issuer of any trades. Executive officers and directors are also typically provided periodic training and education related to their obligations under Section 16.

Under Sections 13(d) and 13(g)[2] of the Exchange Act, Schedules 13D and 13G are reports that beneficial owners of more than 5% of a registered class of a company's voting equity securities must use to report their holdings and intentions with respect to the company. A Schedule 13D must be filed within 10 calendar days of the time the person exceeds the 5% threshold and must be "promptly" amended for material changes, including any increase or decrease of beneficial ownership by more than 1% of the outstanding class of equity securities. A short-form Schedule 13G may be filed by so-called "passive investors"[3] within 10 calendar days of exceeding the 5% threshold and then updated:

- for any increase in beneficial ownership in excess of 10% and thereafter any increase or decrease by more than 5%;
- to a Schedule 13D when exceeding the 20% threshold; and
- for all changes within 45 days after year-end.

The SEC takes the position that there is "no state of mind requirement for violations of Sections 16(a) and 13(d) and the rules thereunder. The failure to timely file a required report, even if inadvertent, constitutes a violation."[4]

ANALYSIS

The charges stem from an SEC enforcement initiative focused on Form 4 and Schedules 13D and 13G filings that company insiders are required to file regarding their holding of and transactions in company securities. The SEC charged six officers, directors, and major shareholders of public companies and five public companies for failing to file Forms 4 and Schedules 13D and 13G on a timely basis. The SEC staff identified with data analytics that the insiders charged "repeatedly [file] these reports late," some delayed "by weeks, months, or even years."

A. Section 16(a) Violations by Insiders

The SEC emphasizes in these recent actions that the insider himself/herself has the responsibility to comply with insider reporting requirements. For example, in one action, the SEC observed that, although it "has encouraged the practice of many issuers to 'help their [officers and directors] or submit the . . . filings on their behalf . . . [in order] to facilitate accurate and timely filing,' Section 16 places the responsibility to report changes in securities ownership on insiders." While the respondent in one action "represented that certain of his delinquent filings resulted from the failure of [the issuer] to make timely filings on his behalf and the failure of his broker to timely notify [the issuer] of certain transactions," the SEC took the view that these failures did not excuse his violations, especially since, according to the SEC, the respondent took inadequate and ineffective steps to monitor whether his broker was providing timely notice to the issuer and whether the issuer made timely and accurate filings on his behalf.[5]

B. Section 16(a) Violations by Issuers

It is noteworthy that the SEC charged issuers for negligently causing the Section 16(a) reporting violations and for violations of Item 405 by failing to report filing delinquencies. The SEC faulted these issuers for "negligence in performing certain tasks [they] voluntarily agreed to undertake in connection with the preparation and filing of Section 16(a) reports" on behalf of their officers and directors.[6] In one case, the SEC alleged that, during a four-year period, the issuer failed to prepare and file Forms 4 for reportable transactions that occurred on more than 60 dates despite receiving timely notification.[7]

The issuers' disclosure controls and procedures related to Item 405 were faulted for:

- failing to request annual certifications on the absence of late Section 16 filings from executive officers and directors;
- failing to disclose the number of late filings and transactions; and
- including misleading proxy disclosures, such as attributing the late filings to administrative errors.

C. Sections 13(d) and 13(g) Violations

The SEC also charged three individuals for Sections 13(d) and 13(g) reporting violations, including for one individual's failure to timely file Schedule 13D amendments for material acquisitions and dispositions of shares constituting more than 1% of the company's outstanding common stock, and another's failure to timely transition from making a Schedule 13G filing to a Schedule 13D when his beneficial ownership exceeded 20%.

IMPLICATIONS

In these actions, the SEC has emphasized its determination to enforce Section 16(a) reporting requirements on insiders as well as issuers that voluntarily undertake the filing responsibility on behalf of their insiders. Issuers that commit to make Section 16(a) filings on behalf of their executive officers and directors should review and, if necessary, enhance their disclosure controls and procedures to ensure that they receive timely notification of reportable transactions, and maintain and follow procedures for filing required reports on time.

In all cases, the insider bears the ultimate responsibility of compliance. Therefore, executive officers and directors should ensure they provide timely notice of reportable transactions to their companies and take active steps to confirm the timeliness and accuracy of the filings made on their behalf.

With respect to Item 405 disclosures, issuers should ensure they receive annual certifications on the absence of late reports from their executive officers and directors, check their records to ensure they lack notice of any late Section 16 filings and, if disclosure of the reason(s) for the late filings is made, ensure the accuracy and completeness of this disclosure.

Persons required to file on Schedule 13D or Schedule 13G should review their procedures and policies to ensure:

- the initial filing is made in a timely manner and on the correct form;
- beneficial ownership is tracked to ensure timely amendments to reflect changes in that ownership and, in particular, the 1% threshold for Schedule 13D filings;
- other material changes to a Schedule 13D are reflected in amendments promptly; and
- an amendment is made within 45 days after year-end to reflect any changes on a Schedule 13G.

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ENDNOTES

[1] U.S. Securities & Exchange Commission, Press Release, *SEC Charges Corporate Insiders for Failing to Timely Report Transactions and Holdings* (September 27, 2023), *available at* https://www.sec.gov/news/press-release/2023-201.

[2] On February 10, 2022, the SEC proposed certain amendments to Regulation 13D-G and Regulation S-T to, among other things, shorten the filing deadlines for beneficial ownership reports on Schedules 13D and 13G, expand the application of Regulation 13D-G to certain cash-settled derivative securities and broaden the circumstances under which persons are treated as a "group." *See* our client memo on this topic at https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/sc-publication-sec-proposes-changes-to-beneficial-ownership-reporting.pdf.

[3] 17 C.F.R. § 240.13d-1(c).

[4] In the Matter of Nicole M. Fernandez McGovern, Release No. 98546 (September 27, 2023), *available at* https://www.sec.gov/files/litigation/admin/2023/34-98546.pdf.

[5] In the Matter of Avery More, Release No. 98543 (September 27, 2023), *available at* https://www.sec.gov/files/litigation/admin/2023/34-98543.pdf.

[6] In the Matter of Cumberland Pharmaceuticals Inc., Release No. 98553 (September 27, 2023), *available at* https://www.sec.gov/files/litigation/admin/2023/34-98553.pdf.

[7] In the Matter of SolarEdge Technologies, Inc., Release No. 98549 (September 27, 2023), *available at* https://www.sec.gov/files/litigation/admin/2023/34-98549.pdf.

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