

the competition with other exchanges. Rather, the Exchange believes the proposed changes will enhance competition for listings, as it will increase the competition for new listings and the listing of companies that are currently listed on other exchanges. Other exchanges can also offer similar services to companies, thereby increasing competition to the benefit of those companies and their shareholders. Accordingly, the Exchange does not believe the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

In addition, the Exchange does not believe that the proposal to extend the period for which it provides certain complimentary products and services to Eligible New Listings and Eligible Transfer Companies will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. In this regard, the NYSE notes that the specific tools and services offered to Eligible New Listings and Eligible Transfer Companies as part of the complimentary offering limited to those categories of issuers under Section 907.00 are provided solely by third-party vendors. In addition, the NYSE may choose to use multiple vendors for the same type of product or service. The NYSE also notes that currently listed and newly listed companies would not be required to accept the offered products and services from the NYSE, and an issuer's receipt of an NYSE listing is not conditioned on the issuer's acceptance of such products and services. In addition, the NYSE notes that, from time to time, issuers elect to purchase products and services from other vendors at their own expense instead of accepting the products and services described above offered by the Exchange.

Moreover, the number of companies eligible for the complimentary products and services for a longer period of time (*i.e.*, companies newly listing on the NYSE) will be very small in comparison to the total number of companies that comprise the target market for the services (*i.e.*, all public companies), so that there can be no competitively meaningful foreclosure of similar services offered by third parties if the proposed rule is approved.

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

No written comments were solicited or received with respect to the proposed rule change.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2020-94 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to: Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.
- All submissions should refer to File Number SR-NYSE-2020-94. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for

inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2020-94 and should be submitted on or before December 18, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

**J. Matthew DeLesDernier**,  
Assistant Secretary.

[FR Doc. 2020-26143 Filed 11-25-20; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90473; File No. PCAOB-2020-01]

### Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendments to PCAOB Interim Independence Standards and PCAOB Rules To Align With Amendments to Rule 2-01 of Regulation S-X

November 20, 2020.

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act" or "Sarbanes-Oxley Act"), notice is hereby given that on November 20, 2020, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or "SEC") the proposed rules described in Items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

#### I. Board's Statement of the Terms of Substance of the Proposed Rules

On November 19, 2020, the Board adopted amendments to the PCAOB's interim independence standards and PCAOB rules to align with amendments by the SEC to Rule 2-01 of Regulation S-X (collectively, the "proposed rules"). The text of the proposed rules appears in Exhibit A to the SEC Filing Form 19b-4 and is available on the Board's website at <https://pcaobus.org/Rulemaking/Pages/Docket047.aspx> and at the Commission's Public Reference Room.

<sup>13</sup> 17 CFR 200.30-3(a)(12).

## II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, the Board is requesting that, pursuant to Section 103(a)(3)(C) of the Sarbanes-Oxley Act, the Commission approve the proposed rules for application to audits of emerging growth companies ("EGCs").<sup>1</sup> The Board's request is set forth in section D.

### A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

#### (a) Purpose Summary

The federal securities laws require, among other things, that issuers, brokers, and dealers file certain periodic reports with the SEC that contain financial statements audited by an independent public accountant. These laws recognize that audits conducted by objective and impartial professionals can protect investors and instill confidence in the public markets.

Congress has provided both the SEC and the PCAOB with jurisdiction to establish auditor independence standards for audits of issuers and broker-dealers. The Sarbanes-Oxley Act specifically authorizes the PCAOB to establish independence standards and rules to be used by registered public accounting firms in the preparation and issuance of audit reports, and as may be necessary or appropriate in the public interest or for the protection of investors.<sup>2</sup>

The Board first exercised its authority under the Act by adopting the independence standards of the American Institute of Certified Public Accountants ("AICPA"), as they existed as of April 16, 2003, as the Board's interim independence standards, and subsequently adopted independence rules set out in Section 3, Part 5 of the Rules of the Board. Although the PCAOB's standard-setting authority

initially extended only to audits of issuers, as defined in the Act,<sup>3</sup> the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") extended that authority to include audits of brokers and dealers.

Because both the PCAOB and the SEC have jurisdiction with respect to auditor independence, it is important for the PCAOB to consider how its independence standards and rules relate to the SEC's requirements, including Rule 2-01 of Regulation S-X ("Rule 2-01").<sup>4</sup> The PCAOB's interim independence standards, as adopted from the AICPA in 2003, cover many of the same topics as Rule 2-01. Recognizing the overlap, the Board directed audit firms in 2003 to comply with the more restrictive of the Board's interim independence standards and Rule 2-01. Subsequently, the PCAOB's permanent independence rules have imposed certain incremental independence obligations (e.g., additional prohibitions on tax services for persons in financial reporting oversight roles at issuer audit clients<sup>5</sup>) on registered public accounting firms. The PCAOB's independence rules use definitions aligned with the definitions in the SEC's Rule 2-01(f).

From 2003 to 2018, the SEC's requirements and the PCAOB's interim independence standards and independence rules worked together to establish the independence compliance requirements for auditors subject to the Board's jurisdiction. In 2018, however, the SEC began the process of making certain amendments to Rule 2-01. Specifically, the Commission proposed in 2018, and then adopted in 2019, amendments to Rule 2-01(c)(1)(ii)(A) to refocus the analysis that must be conducted to determine whether an auditor is independent when the auditor has a lending relationship with certain shareholders of an audit client at any time during the audit and professional engagement period. The Commission next proposed in 2019, and then adopted in 2020, additional amendments to address certain arrangements and relationships that the SEC believed were less likely to threaten an auditor's objectivity or impartiality, so that auditors and audit committees could spend more time focusing on relationships that are more likely to pose such threats.<sup>6</sup> Several commenters on the latter proposal noted that the

SEC's proposed amendments overlapped with the PCAOB's requirements relating to lending arrangements and further observed that the SEC's proposal to amend certain definitions in Rule 2-01(f) might give rise to differences with some of the Board's existing definitions in Rule 3501.

To avoid differences and duplicative requirements, and to provide greater regulatory certainty, the Board adopted targeted amendments to its interim independence standards applicable to lending arrangements between auditors and audit clients. In addition, the Board adopted targeted amendments to align certain terms defined in Rule 3501 with the Commission's recent amendments to its definitions of those terms in Rule 2-01(f).

#### Background

##### SEC Authority and Independence Requirements

The federal securities laws authorize the SEC to establish independence requirements for audits of financial statements filed with the Commission.<sup>7</sup> The SEC's rule on auditor independence is Rule 2-01, which the SEC has described as setting forth a "comprehensive framework governing auditor independence."<sup>8</sup> Under the general standard in Rule 2-01(b), the SEC "will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement."

In addition to the general standard in Rule 2-01(b), the rule includes a non-exclusive specification of circumstances that are inconsistent with Rule 2-01(b). Rule 2-01(c)(1)-(4) addresses financial, employment, and business relationships between accountants and their audit clients, as well as the performance of certain non-audit services. Other provisions of Rule 2-01(c)-(e) address contingent fees, partner rotation on audit engagements, audit committee administration of the audit engagement, partner compensation, independence quality controls, and grandfathering and transition provisions.<sup>9</sup> Rule 2-01(f)

<sup>7</sup> See, e.g., *Strengthening the Commission's Requirements Regarding Auditor Independence*, Release No. 33-8183 (Jan. 28, 2003), 68 FR 6006, 6044 (Feb. 5, 2003) (identifying the SEC's statutory bases to adopt independence requirements).

<sup>8</sup> See *Amendments to Rule 2-01, Qualifications of Accountants*, Release No. 33-10738 (Dec. 30, 2019), 85 FR 2332 (Jan. 15, 2020) ("2020 Proposing Release").

<sup>9</sup> See Rule 2-01(c)(5)-(8) and Rule 2-01(d)-(e).

<sup>1</sup> The term "emerging growth company" is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(80)). See also *Inflation Adjustments and Other Technical Amendments Under Titles I and III of the JOBS Act*, Rel. 33-10332 (Mar. 31, 2017), 82 FR 17545 (Apr. 12, 2017).

<sup>2</sup> 15 U.S.C. 7213.

<sup>3</sup> See Section 2(a)(7) of the Act, 15 U.S.C. 7201(a)(7).

<sup>4</sup> See 17 CFR 210.2-01.

<sup>5</sup> PCAOB Rule 3523.

<sup>6</sup> See *Qualifications of Accountants*, Release No. 33-10876 (Oct. 16, 2020) ("2020 Adopting Release").

defines certain terms used in Rule 2–01. The Commission’s interpretations on auditor independence are collected in the Codification of Financial Reporting Policies,<sup>10</sup> and the SEC staff has also issued “Frequently Asked Questions” on auditor independence.<sup>11</sup>

#### PCAOB Authority and Independence Requirements

Under the Act, the Board is authorized to establish ethics and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by the Act or SEC rules, or “as may be necessary or appropriate in the public interest or for the protection of investors.”<sup>12</sup> The Act also authorized the Board to adopt as its rules other professional standards that the Board determined satisfied the requirements of Section 103(a)(1) of the Act.<sup>13</sup>

When the PCAOB was established in 2003, the Board adopted the professional standards promulgated by other bodies, including the AICPA, on an interim basis, as authorized under the Act,<sup>14</sup> which assured continuity and certainty in the standards that govern audits of public companies.<sup>15</sup> The Board further stated that it would determine whether to adopt its interim standards as permanent standards of the Board, or repeal or modify those standards, in the future.<sup>16</sup> Currently, Rule 3500T, *Interim Ethics and Independence Standards*, requires registered public accounting firms to comply with independence standards as described in Rule 101 of the AICPA’s Code of Professional Conduct (“AICPA Code”), as well as the AICPA’s interpretations and rulings thereunder that appear in ET §§ 101 and 191, as in existence on April 16, 2003, to the extent not superseded or amended by the Board.<sup>17</sup> A Note to Rule 3500T also states that the Board’s interim independence

standards do not supersede the Commission’s auditor independence rules and that registered public accounting firms must comply with the “more restrictive” of the rules.<sup>18</sup>

The PCAOB began to adopt permanent independence rules in 2005.<sup>19</sup> These rules set forth the fundamental ethical obligation for a registered public accounting firm and its associated persons to be independent of the firm’s audit clients throughout the audit and professional engagement period,<sup>20</sup> and include definitions of certain terms used in the Board’s independence rules.<sup>21</sup> The rules also prohibit contingent fee arrangements for any service or product a registered public accounting firm provides to an audit client (Rule 3521), restrict certain types of tax services that may be provided to an audit client and to persons in a financial reporting oversight role at an issuer audit client (Rules 3522 and 3523), require audit committee pre-approval of certain tax services and services related to internal

control over financial reporting to be performed for an issuer audit client (Rules 3524 and 3525), and require certain communications with an audit client’s audit committee concerning auditor independence (Rule 3526). In 2013, after Dodd-Frank was enacted, the Board adopted amendments to certain of these rules to extend their application to audits of brokers and dealers.<sup>22</sup>

#### Recent SEC Amendments to Rule 2–01

From 2003 through 2019, there were no changes to Rule 2–01 by the Commission. In June 2019, the SEC adopted amendments to Rule 2–01(c)(1)(ii)(A) (the “Loan Provision”) “to refocus the analysis that must be conducted to determine whether an auditor is independent when the auditor has a lending relationship with certain shareholders of an audit client at any time during the audit and professional engagement period.”<sup>23</sup> The Commission further stated that the amendments “would more effectively identify those debtor-creditor relationships that could impair an auditor’s objectivity and impartiality, yet would not include certain attenuated relationships that are unlikely to present threats to objectivity or impartiality.”<sup>24</sup>

In December 2019, the SEC proposed further updates to Rule 2–01, including additional amendments to the provisions of Rule 2–01(c)(1) that address lending relationships. In proposing these amendments, the SEC stated that they were intended “to more effectively focus the [independence] analysis on those relationships or services that are more likely to pose threats to an auditor’s objectivity and impartiality.”<sup>25</sup> After considering public comments on the proposal, the Commission amended Rule 2–01 again in October 2020.<sup>26</sup>

The final amendments added certain student and consumer loans to the Commission’s categorical exclusions from independence-impairing lending relationships. The SEC also updated several of the definitions in Rule 2–01(f), including amendments to the definitions of the terms “affiliate of the audit client” and “investment company complex” in Rule 2–01(f)(4) and (f)(14) to address certain affiliate relationships, including entities under common control, and an amendment to the definition of “audit and professional

<sup>10</sup> See Codification of Financial Reporting Policies, Section 600, *Matters Relating to Independent Accountants*.

<sup>11</sup> See Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence Frequently Asked Questions, available at <https://www.sec.gov/info/accountants/ocafaquandind080607.htm>.

<sup>12</sup> See Sections 103(a)(1) and 103(b) of the Act, 15 U.S.C. 7213(a)(1) and (b).

<sup>13</sup> See Section 103(a)(3)(A) of the Act, 15 U.S.C. 7213(a)(3)(A).

<sup>14</sup> See Section 103(a)(3)(B) of the Act, 15 U.S.C. 7213(a)(3)(B).

<sup>15</sup> See PCAOB Rel. No. 2003–006, *Establishment of Interim Professional Auditing Standards* (Apr. 18, 2003) (“2003 Adopting Release”).

<sup>16</sup> See *id.* at 3.

<sup>17</sup> Rule 3500T also requires compliance with (1) certain independence standards and interpretations of the former Independence Standards Board, to the extent not superseded by the Board and (2) certain ethics standards described in Rule 102 of the AICPA Code and the related interpretations and rulings thereunder, as in existence on April 16, 2003, to the extent not superseded or amended by the Board.

<sup>18</sup> See also PCAOB Release No. 2013–010, *Amendments to Conform the Board’s Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications* (Dec. 4, 2013) at 20 fn. 60 (stating that the Note to Rule 3500T “means that the less restrictive rule still applies but satisfying the more restrictive rule is deemed to satisfy the less restrictive rule”).

<sup>19</sup> In 2005, the Board adopted Rules 3501–3502 and Rules 3520–3524. See PCAOB Release No. 2005–014, *Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees* (July 26, 2005) (“2005 Adopting Release”). In 2007 and 2008, the Board adopted Rules 3525 and 3526, respectively. See PCAOB Release No. 2007–005, *Auditing Standard No. 5—An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements and Related Independence Rule and Conforming Amendments* (May 24, 2007); PCAOB Release No. 2008–003, *Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence, Amendment to Interim Independence Standards, Amendment to Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles, Implementation Schedule for Rule 3523* (Apr. 22, 2008).

<sup>20</sup> See PCAOB Rule 3520. Registered public accounting firms must satisfy not only the Board’s independence requirements, but also all other independence criteria applicable to a firm’s engagement, including Rule 2–01. See Note 1 to PCAOB Rule 3520.

<sup>21</sup> In adopting the definitions in Rule 3501, the Board stated that many of those definitions were based on the SEC’s existing definitions of those terms in Rule 2–01. See, e.g., 2005 Adopting Release at 19 n. 36 (the Board’s definition of the term “audit and professional engagement period” in Rule 3501(a)(iii) “adapts the definition of ‘audit and professional engagement period’ from the definition of that term in \* \* \* Rule 2–01 of the Commission’s Regulation S–X”); *id.* at 21 n. 43 (the Board’s definitions of the terms “affiliate of the audit client” and “investment company complex” in Rules 3501(a)(i) and 3501(i)(ii) are “verbatim the SEC’s definitions of these same terms and should be understood to cover the same entities that would be covered by these terms in applying the SEC’s independence rules”).

<sup>22</sup> See PCAOB Release No. 2013–010.

<sup>23</sup> See *Auditor Independence With Respect to Certain Loans or Debtor-Creditor Relationships*, Release No. 33–10648 (June 18, 2019), 84 FR 32040 (July 5, 2019) (“2019 Adopting Release”).

<sup>24</sup> *Id.* at 84 FR 32043.

<sup>25</sup> See 2020 Proposing Release at 85 FR 2350.

<sup>26</sup> See 2020 Adopting Release.

engagement period” in Rule 2–01(f)(5) to shorten the “look back period” for domestic first-time filers in assessing compliance with the Commission’s independence requirements.<sup>27</sup>

## Amendments to the Board’s Independence Requirements

### Overview

The Board adopted amendments to the PCAOB’s interim independence standards and independence rules to eliminate differences and duplicative requirements in its independence requirements following the SEC’s amendments to Rule 2–01 in 2019 and 2020, respectively. Specifically, as discussed below, the Board amended ET § 101.02 and deleted ET § 101.07, both of which are interpretations of Rule 101 of the AICPA Code that are part of the Board’s interim independence standards. In addition, the Board deleted ET §§ 191.150–151, ET §§ 191.182–183, ET §§ 191.196–197, and ET §§ 191.220–222, which are four Ethics Rulings under Rule 101 that also address lending arrangements and are part of the Board’s interim independence standards. Finally, the Board amended Rule 3501, which defines certain terms used in Section 3, Part 5 of the Rules of the Board, to align the definitions of three terms used in the independence requirements of both the SEC and the PCAOB.<sup>28</sup>

<sup>27</sup> Other revisions to Rule 2–01 adopted by the SEC included an amendment to the Commission’s restriction on business relationships in Rule 2–01(c)(3), an amendment to replace an existing transition and grandfathering provision in Rule 2–01(e) with a new transition provision addressing mergers or acquisitions involving an audit client, and certain miscellaneous updates.

<sup>28</sup> The Board also considered whether to amend the Board’s independence rules to align with the SEC’s new provision for addressing inadvertent violations described in Rule 2–01(e). Rule 2–01(e) provides that an accounting firm’s independence will not be impaired because an audit client engages in a merger or acquisition that gives rise to a relationship or service that is inconsistent with Rule 2–01, provided that the firm satisfies certain conditions, which include having a quality control system in place as described in Rule 2–01(d)(3) with specified features. The PCAOB has an ongoing project to consider revisions to the Board’s quality control standards, including an ethics and independence component that would address the fulfillment of firm and individual responsibilities under applicable ethics and independence requirements. See PCAOB Release No. 2019–003, *Potential Approach to Revisions to PCAOB Quality Control Standards* (Dec. 17, 2019). Accordingly, the Board believed it would be premature to amend its independence rules to conform to the SEC’s exemption described in Rule 2–01(e). Pending further action, however, the Board generally would not expect to consider an accounting firm’s independence impaired solely because an audit client engages in a merger or acquisition that gives rise to a relationship or service that is inconsistent with the Board’s independence rules, provided that the firm has satisfied all the conditions in Rule 2–01(e). In such circumstances, firms should also

As discussed further below, without amendments to the Board’s interim independence standards, certain provisions that address lending relationships would overlap with and differ from Rule 2–01, as amended. Specifically, ET § 101.02 and ET § 101.07 would be inconsistent with the SEC’s restrictions on lending relationships and the exceptions to those restrictions in Rule 2–01(c)(1)(ii), as amended. In addition, the four Ethics Rulings would also be inconsistent with the Commission’s independence requirements.

Moreover, absent amendments to the Board’s definitions of the terms “affiliate of the audit client,” “audit and professional engagement period,” and “investment company complex” in Rule 3501(a)(ii), (a)(iii), and (i)(ii), these definitions would differ from the SEC’s definitions of those terms in Rule 2–01(f)(4), (f)(5), and (f)(14), as amended. Confusion might arise if certain terms used in both the PCAOB’s and the SEC’s independence rules were defined differently by the Board and the Commission.<sup>29</sup>

These targeted amendments to the Board’s independence requirements apply to all audits conducted under PCAOB standards. The amendments should clarify the professional obligations of auditors and avoid regulatory uncertainty regarding the treatment of lending arrangements and the scope of the definitions in the independence requirements of the PCAOB and the SEC.

### Amendments to Interim Independence Standards

The SEC’s 2019 amendments to Rule 2–01(c)(1)(ii)(A)(1) replaced the category of owners of an audit client’s equity securities whose lending relationships with an accountant may impair independence (“any individuals owning ten percent or more of the client’s outstanding equity securities”) with “beneficial owners (known through reasonable inquiry) of the audit client’s equity securities where such beneficial owner has significant influence over the client.” At that time, the Commission stated that it had become aware that “in certain circumstances, the existing [requirement] may not be functioning as

consider their obligations under Rule 3526, *Communication with Audit Committees Concerning Independence*.

<sup>29</sup> See 2005 Adopting Release at 19–21. Several commenters on the 2020 Proposing Release identified a potential inconsistency between the Commission’s proposed amendments to the definitions in Rule 2–01 and the existing definitions in Rule 3501 and urged the SEC and the PCAOB to preserve the alignment of the definitions in Rule 2–01 with the Board’s definitions in Rule 3501.

it was intended,” and that the amendments “would more effectively identify those debtor-creditor relationships that could impair an auditor’s objectivity and impartiality,” while excluding “certain attenuated relationships that are unlikely to present threats to objectivity or impartiality.”<sup>30</sup>

In addition, as amended in October 2020, Rule 2–01(c)(1)(ii)(A)(1) includes an exception from the scope of the Loan Provision for student loans obtained from a financial institution client under its normal lending procedures, terms, and requirements by a covered person in a firm or his or her immediate family members, provided the loans were not obtained while the covered person was a covered person. The amendments also replace a prior exception in Rule 2–01(c)(1)(ii)(E) for certain credit card balances and cash advances from a lender that is an audit client with an exception for consumer loans, provided that the aggregate outstanding balance is reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period.<sup>31</sup>

The amendments to Rule 2–01 in 2019 and 2020 created differences between Rule 2–01 and the Board’s independence requirements. Under Rule 3500T, registered public accounting firms and their associated persons must comply with independence standards in Rule 101 of the AICPA Code and the interpretations and rulings thereunder, as in existence on April 16, 2003, to the extent not superseded or amended by the Board. These interpretations include ET § 101.02, which provides, among other things, that loans from owners of 10% or more of an audit client’s equity securities to an accounting firm, other individuals who fall within the definition of a “covered member” of the firm,<sup>32</sup> and the immediate family of

<sup>30</sup> See 2019 Adopting Release at 84 FR 32042–43.

<sup>31</sup> See 2020 Adopting Release at 53–57 and 59–62. In proposing amendments to Rule 2–01(c)(1)(ii), the SEC reiterated that certain debtor-creditor relationships between an accounting firm, a covered person, or a covered person’s immediate family members “reasonably may be viewed as creating a self-interest that competes with the auditor’s obligation to serve only investors’ interests,” but stated that “not all creditor or debtor relationships threaten an auditor’s objectivity and impartiality.” See 2020 Proposing Release at 85 FR 2339, *citing Revision of the Commission’s Auditor Independence Requirements*, Release No. 33–7870 (June 30, 2000), 65 FR 43148, 43161 (July 12, 2000).

<sup>32</sup> The definition of a “covered member” for purposes of ET § 101.02 and ET § 101.07 is similar to the definition of a “covered person in the firm” in Rule 2–01(f)(11) in certain respects, but differs in other respects. For example, the AICPA’s definition of “covered member,” as of April 16, 2003, includes an accountant’s firm, whereas the SEC’s definition of “covered persons in the firm” in Rule 2–01(f)(11) only includes certain natural persons.

such covered members may impair the accounting firm's independence, unless permitted by ET § 101.07. ET § 101.02 also includes provisions relating to the collection and repayment of loans by covered members who were formerly employed by or otherwise associated with an audit client. In turn, ET § 101.07, which is also an interpretation of Rule 101 of the AICPA Code, reiterates the restrictions on certain loans in ET § 101.02, but provides exceptions for certain grandfathered and permitted loans that are not deemed to impair a covered member's independence. Following the SEC's amendments to Rule 2-01 in 2019 and 2020, the requirements under existing ET § 101.02 and ET § 101.07 with respect to lending arrangements are inconsistent with the Commission's requirements under Rule 2-01, as amended.

ET §§ 191.150-.151, ET §§ 191.182-.183, ET §§ 191.196-.197 and ET §§ 191.220-.221 are four Ethics Rulings under Rule 101 of the AICPA Code, as in existence on April 16, 2003. These rulings (Ethics Rulings 75, 91, 98, and 110) discuss the application of ET § 101.02 and ET § 101.07 regarding lending arrangements in specific circumstances and include references to ET § 101.02, ET § 101.07, or both:

- Ethics Ruling 75 addresses membership in a client credit union and conditions to be followed to preserve independence if loans are made to the auditor, including compliance with requirements with respect to lending arrangements under ET § 101.02 and ET § 101.07.
- Ethics Ruling 91 addresses the leasing by an auditor of property to or from a client and provides that certain capital leases would be considered a loan that impairs independence unless the arrangement complied with requirements with respect to lending arrangements under ET § 101.02 and ET § 101.07.
- Ethics Ruling 98 addresses an auditor's loan from a nonclient subsidiary or parent of an attest client and provides, among other things, that a loan from a nonclient subsidiary would impair the auditor's independence unless it was a grandfathered or permitted loan pursuant to ET § 101.07.

- Ethics Ruling 110 addresses, among other things, loans from an audit firm's client to or from an entity over which an auditor has control and provides that, in such situations, independence is impaired unless the loan is permitted under ET § 101.07.

Each of these rulings also includes other language that is inconsistent with

the SEC's independence requirements. For example, ET §§ 191.150-.151 (Ethics Ruling 75) permits an auditor to have certain uninsured deposits at a credit union client that are not allowed under Rule 2-01(c)(1)(ii)(B), while ET §§ 191.196-.197 (Ethics Ruling 98) provides that certain loans from a nonclient parent of an audit client would not impair independence, even though such loans are not allowed under Rule 2-01(c)(1)(ii)(A) in some circumstances.<sup>33</sup>

The Board updated its requirements with respect to lending relationships to avoid such differences and duplicative requirements. Specifically, the Board amended ET § 101.02 to delete the language in that interpretation that addresses lending arrangements and deleting ET § 101.07 in its entirety. In addition, the Board deleted ET §§ 191.150-.151, ET § 191.182-.183, ET §§ 191.196-.197 and ET §§ 191.220-.221 (Ethics Rulings 75, 91, 98, and 110) to eliminate inconsistent requirements in these rulings relating to lending arrangements under the Board's interim independence standards and the SEC's independence rules and guidance.

The Board took this action in light of the SEC's amendments to Rule 2-01. Removing the provisions relating to lending arrangements from the Board's interim independence standards, rather than making specific amendments to conform them to the SEC's amendments to Rule 2-01, avoids duplicative Board and SEC independence requirements on lending arrangements and helps facilitate compliance with Rule 2-01, as amended, by clarifying a firm's professional obligations. The amendments should also facilitate cooperation and coordination between the Board and the SEC when monitoring compliance with the SEC's revised independence requirements in Rule 2-01.

In adopting the amendments to the interim independence standards, the Board also took notice of the regulatory process employed by the Commission to update its independence framework for lending arrangements in Rule 2-01. Specifically, before amending Rule 2-01

<sup>33</sup> In addition, ET §§ 191.-182-.183 (Ethics Ruling 91) and ET §§ 191.220-.221 (Ethics Ruling 110) are less restrictive in certain respects than Section 602.02.e of the Codification of Financial Reporting Policies. In particular, ET §§ 191.-182-.183 (Ethics Ruling 91) permits an auditor to enter into certain operating leases with an audit client without regard to the materiality of the lease, which is inconsistent with Section 602.02.e, while ET §§ 191.220-.221 (Ethics Ruling 110) differs from Section 602.02.e in describing the circumstances in which a loan to or from an audit client from an entity with which an auditor is connected as an officer, director, or shareholder may impair independence.

in both 2019 and 2020, the SEC issued a rulemaking proposal, identified the Commission's rationale for proposed amendments to Rule 2-01, solicited public comment on its proposals, and included an economic analysis that included a description of the problem, an analysis of potential benefits and costs, and a consideration of alternatives. After receiving public comments on the proposals, many of which broadly supported the objective of the proposed amendments or were generally in favor of the proposals, the Commission then adopted the amendments largely as proposed.<sup>34</sup> The Board has considered the SEC's rulemaking record on both proposals. The Board believed that this process—structured by the Commission to satisfy the requirements of the Administrative Procedure Act—is at least as robust as the Board's process would have been had the PCAOB considered amendments to the Board's independence requirements without the benefit of the SEC's analysis.

Accordingly, the Board did not perceive any reason or compelling basis in the SEC's rulemaking record to disregard the goal of the SEC's 2019 and 2020 amendments or to impede the benefits that the Commission sought to achieve through its revisions to Rule 2-01 by maintaining differences between the independence requirements of the Board and the SEC relating to lending arrangements. If the Board were to determine at a future date that diverging from the SEC's approach to lending arrangements is necessary or appropriate in the public interest or for the protection of investors, the Board retains the authority under the Act to do so.

#### Amendments to Rule 3501

The Board adopted Rule 3501 as part of a suite of independence rules in 2005. Although the Board's permanent independence rules, which now include Rules 3520 through 3526, impose additional substantive restrictions on auditors beyond those set forth in Rule 2-01, the scope of those rules has been consistent with the SEC's approach in Rule 2-01.

Specifically, when the Board adopted Rule 3501, it based the definitions of the terms "affiliate of the audit client" in Rule 3501(a)(ii), "audit and professional

<sup>34</sup> A few commenters did not support the SEC's proposals, and one of these commenters expressed the view that the proposals could negatively affect investor protection and capital formation. This commenter suggested that, in lieu of the proposals, more should be done to strengthen auditor independence standards and the enforcement of such standards. See 2020 Adopting Release at 5-6.

engagement period” in Rule 3501(a)(iii), and “investment company complex” in Rule 3501(i)(ii) on the SEC’s definitions of the same terms in Rule 2–01.<sup>35</sup> The existing definitions of “affiliate of the audit client,” and “investment company complex” in Rule 3501 largely tracked the SEC’s definitions of those terms verbatim, except for different formatting. The definition of “audit and professional engagement period” in Rule 3501 was adapted from the Commission’s definition of that term in Rule 2–01, with the only difference being the replacement of references to an “accountant” in Rule 2–01(f)(5) with references to a “registered public accounting firm” in Rule 3501(a)(iii). This distinction reflects the use of the term “accountant” under Rule 1001(a)(ii) to refer to natural persons who are certified public accountants or authorized to engage in public accounting or participate in audits, whereas Rule 2–01(f)(5) defines the term more broadly to include accounting firms with which certified public accountants or public accountants are affiliated.

The Board’s definitions in Rule 3501, in turn, determine the scope of the substantive requirements in Rules 3520 through 3526.<sup>36</sup> Rules 3520 through 3526 address independence matters in addition to those expressly addressed in Rule 2–01, including the impact of certain tax services on independence (Rules 3522 and 3523), audit committee pre-approval of certain tax services and services related to internal control over financial reporting (Rules 3524 and 3525), and communications with audit committees concerning independence (Rule 3526).<sup>37</sup>

The SEC’s amendments to Rule 2–01 in 2020 included revisions to the definitions of each of the terms “affiliate of the audit client,” “audit and professional engagement period,” and “investment company complex” in Rule 2–01(f). These amendments resulted in differences between the SEC’s definitions of those terms and the Board’s definitions in Rule 3501. Discussed in more detail below are (1) the relevant SEC amendments and why the Commission changed these definitions; (2) the resulting differences

between the SEC’s amended definitions and the Board’s existing definitions; and (3) why and how the Board amended the definitions of these three terms in Rule 3501 to avoid differences with the SEC’s amended definitions.

As discussed above with respect to the amendments to the Board’s interim independence standards, in amending the definitions of “affiliate of the audit client,” “investment company complex,” and “audit and professional engagement period” in Rule 3501, the Board took note of the SEC’s rulemaking process when the Commission amended the definitions of those terms in Rule 2–01(f) in 2020. The SEC’s robust process included a detailed rationale for the amendments to the definitions and was also informed by public comment on the Commission’s proposals. The Board believed it was important to align the definitions of these terms in Rule 3501 with the SEC’s amended definitions in Rule 2–01(f) to ensure they have the same meaning under the independence rules of the Board and the SEC and avoid the confusion that might arise if the same terms were used in the independence rules of the PCAOB and the Commission, but defined differently.

#### “Affiliate of the Audit Client” and “Investment Company Complex” Definitions

Prior to the SEC’s 2020 amendments to Rule 2–01, the term “affiliate of the audit client” was defined in Rule 2–01(f)(4) to include, in part, both “[a]n entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client’s parents and subsidiaries” and “[e]ach entity in the *investment company complex* when the audit client is an entity that is part of an investment company complex” (emphasis added). Rule 2–01(f)(14), in turn, had defined an “investment company complex” to include, in part, “[a]ny entity controlled by or controlling an investment adviser or sponsor \* \* \* or any entity under common control with an investment adviser or sponsor \* \* \* if the entity: (1) Is an investment adviser or sponsor; or (2) Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor \* \* \*.”

In its 2020 amendments to Rule 2–01, the Commission amended these definitions to address challenges that had arisen in their application, including in the private equity and investment company contexts, and more effectively focus on those relationships

and services that the SEC believed were more likely to threaten auditor objectivity and impartiality. The SEC’s amendments also include dual materiality thresholds in the respective common control provisions and distinguish how the definition applies when an accountant is auditing a portfolio company, an investment company, or an investment adviser or sponsor.

The SEC’s amendments created differences with certain definitions in Rule 3501. Accordingly, the Board aligned the definitions of the terms “affiliate of the audit client” and “investment company complex” in Rule 3501 to be consistent with the SEC’s 2020 amendments to the definitions of these terms in Rule 2–01(f). The Board’s amendments to these definitions avoid potential confusion by auditors when applying the independence rules of the SEC and PCAOB; without such amendments, auditors would be required to undertake a different analysis to determine which entities fall within or outside the scope of the “affiliate of the audit client” and “investment company complex” definitions (and, therefore, considered the “audit client”) for purposes of Rule 2–01 and the Board’s rules.

Accordingly, the Board amended Rule 3501(a)(ii) and Rule 3501(i)(ii) to conform to the SEC’s amended definitions in Rule 2–01(f)(4) and 2–01(f)(14). Specifically, the Board amended these definitions to incorporate the SEC’s amended definitions by cross-referencing the SEC’s definitions in Rule 2–01(f). This approach is intended to facilitate the continued alignment of the Board’s definitions in Rule 3501(a)(ii) and Rule 3501(i)(ii) with the SEC’s definitions in Rule 2–01(f). In the event of later changes by the SEC to the scope of those definitions in Rule 2–01(f), the definitions of these terms in Rule 3501 would automatically update, without requiring further action by the Board.<sup>38</sup> The Board did not delete these definitions, as it did with respect to the provisions of the Board’s interim independence standards that address lending arrangements and overlap with the SEC’s independence criteria, because the definitions in Rule 3501 remain relevant for purposes of Rules

<sup>35</sup> See 2005 Adopting Release at 19–21.

<sup>36</sup> Specifically the term “investment company complex” appears in the definition of “affiliate of the audit client.” In turn, the term “affiliate of the audit client” appears in the definition of the term “audit client,” which is used in each of Rules 3520 through 3526.

<sup>37</sup> In addition, both the SEC and the PCAOB have adopted restrictions on the receipt of contingent fees by audit firms. The Commission’s restrictions are set forth in Rule 2–01(c)(5), and the Board’s restrictions are set forth in Rule 3521.

<sup>38</sup> The Board only amended through cross-references those definitions in Rule 3501 that were identical to the SEC’s definitions in Rule 2–01(f) and also the subject of the Commission’s 2020 amendments. Certain other defined terms in Rule 3501, such as the definitions of “financial reporting oversight role” and “immediate family member” in Rules 3501(f)(i) and 3501(i)(i), respectively, continue to track the text of the SEC’s definitions of those terms in Rule 2–01(f).

3520 through 3526, which are part of the Board's permanent independence rules. The Board retains the authority to amend these definitions in the future, should the Board determine that such amendments are necessary or appropriate in the public interest or for the protection of investors.

#### “Audit and Professional Engagement Period” Definition

Prior to its amendment by the SEC in 2020, the term “audit and professional engagement period” had been defined differently in Rule 2–01(f)(5) for domestic issuers and for foreign private issuers (“FPIs”) with respect to situations where a company first files, or is required to file, a registration statement or report with the Commission.<sup>39</sup> Specifically, Rule 2–01(f)(5)(i) and (ii) had defined the “audit and professional engagement period” to include both the “period covered by the financial statements being audited or reviewed” and the “period of the engagement to audit or review the financial statements or to prepare a report filed with the Commission.” For audits of the financial statements of FPIs, however, Rule 2–01(f)(5)(iii) narrowed the “audit and professional engagement period” to exclude periods prior to “the first day of the last fiscal year before the [FPI] first filed, or was required to file, a registration statement or report with the Commission, provided there has been full compliance with home country independence standards in all prior periods covered by any registration statement or report filed with the Commission.”

Under the SEC's amendments to the definition of “audit and professional engagement period” in Rule 2–01(f)(5)(iii), the one-year “look back” provision for issuers filing or required to file a registration statement or report with the Commission for the first time (“first-time filers”) will apply to all such filers. As a result, an auditor for a first-time filer that is either a domestic issuer or an FPI would apply Rule 2–01 for the most recently completed fiscal year included in its first filing, provided there has been full compliance with applicable independence standards in all prior periods covered by any registration statement or report filed with the Commission. In amending Rule

2–01(f)(5)(iii), the SEC stated that the prior definition of “audit and professional engagement period” may have resulted in certain inefficiencies in the initial public offering (“IPO”) process for domestic filers, and that the narrower definition applicable to FPIs had created a disparate application of the independence requirements between domestic issuers and FPIs.<sup>40</sup>

The Commission's amendment to Rule 2–01(f)(5)(iii) created a difference between that definition and the definition of “audit and professional engagement period” in Rule 3501(a)(iii), specifically under paragraph (3) of this definition. Maintaining different definitions of this term under the independence rules of the SEC and PCAOB could lead to potential confusion among auditors, since the term “audit and professional engagement period” appears in numerous provisions of Rule 2–01, while Rules 3520 through 3523 also set forth certain circumstances that are deemed to impair an audit firm's independence if they occur during either the “audit and professional engagement period” or the “professional engagement period.”

To avoid this potential confusion when applying the independence rules of the SEC and PCAOB, the Board amended the definition of “audit and professional engagement period” in Rule 3501(a)(iii)(3) to be consistent with the SEC's amendment to Rule 2–01(f)(5)(iii). As discussed above with respect to the amendments to the definitions of “affiliate of the audit client” and “investment company complex,” without an amendment to this definition, it would no longer be consistent with the SEC's definition in Rule 2–01(f)(5)(iii), as has been the case since the Board adopted its definition in 2005. Instead, the one-year look back period would apply to both domestic issuers and FPIs that were first-time filers under Rule 2–01, but only to FPIs that were first-time filers under Rule 3501(a)(iii)(3).

The Board did not replace the current definition of “audit and professional engagement period,” however, with a cross-reference to Rule 2–01(f)(5). Specifically, the Board continued to use the term “registered public accounting firm” in the definition of “audit and professional engagement period,” rather than the term “accountant,” which is used in Rule 2–01(f)(5). The term “accountant” has a different meaning under Rule 1001(a)(ii) than under Rule 2–01(f)(1), whereas the use of the term “registered public accounting firm” is

consistent with the Act and other rules of the Board. As with the SEC's amendment to Rule 2–01(f)(5)(iii) in 2020, under Rule 3501(a)(iii)(3), as amended, the one-year look back period will apply to both domestic issuers and FPIs that are first-time filers.

#### Administrative Considerations

The Board took action to make targeted amendments to its interim independence standards and Rule 3501 in light of the SEC's recent amendments to Rule 2–01. Removing the provisions relating to lending arrangements from the Board's interim independence standards avoids differences and duplicative PCAOB and Commission requirements that would otherwise exist after the effective date of the SEC's amendments to the independence requirements in Rule 2–01(c)(1)(ii) on lending arrangements. The Board also amended the definitions of certain terms used in Rule 3501 to align these definitions with the SEC's amended definitions of the same terms in Rule 2–01(f) to ensure they have the same meaning under the independence rules of the Board and the SEC. The Board believed the regulatory process employed by the Commission to update its independence rules under Rule 2–01 was at least as robust as the Board's process would have been had the PCAOB considered amendments to the Board's independence requirements without the benefits of the SEC's analysis. Therefore, the Board believed that public notice and comment in advance of adopting these targeted amendments to the Board's independence requirements was not necessary.

#### Effective Date

The Board determined that the targeted amendments to its interim independence analysis and Rule 3501 take effect, subject to approval by the SEC, 180 days after the date of the publication of the SEC's October 16, 2020 amendments to Rule 2–01 in the **Federal Register**. The effective date is aligned with the effective date of the Commission's amendments to Rule 2–01.<sup>41</sup> Auditors may elect to comply before the effective date at any point after SEC approval of the Board's amendments, provided that the final amendments are applied in their entirety.

#### (b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

<sup>39</sup> A “foreign private issuer” is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents; and (2) any of the following: (i) A majority of its executive officers or directors are citizens or residents of the United States; (ii) more than 50% of its assets are located in the United States; or (iii) its business is principally administered in the United States. See 17 CFR 240.3b–4(c).

<sup>40</sup> See 2020 Adopting Release at 101.

<sup>41</sup> See 2020 Adopting Release at 81.

### *B. Board's Statement on Burden on Competition*

Not applicable. The Board's consideration of the economic impacts of the proposed rules is discussed in section D below.

### *C. Board's Statement on Comments on the Proposed Rules Received From Members, Participants or Others*

The Board did not solicit written comments on the proposed rules. Therefore, there are no comments on the proposed rules received from stakeholders.

### *D. Economic Considerations and Application to Audits of Emerging Growth Companies*

The Board is mindful of the economic impacts of its rulemaking. This section discusses economic considerations related to the amendments, including the need for the rulemaking; description of the baseline; consideration of benefits, costs, and unintended consequences; and alternatives considered. It also discusses considerations related to audits of EGCs.

#### Need for Rulemaking

The Board needed to amend its interim independence standards and independence rules to (1) eliminate differences and duplicative requirements between Rule 2–01 and the Board's independence requirements; and (2) avoid the confusion that might arise if certain terms were used in the independence rules of the PCAOB and the Commission, but defined differently. The Board also did not perceive any reason or compelling basis in the SEC's rulemaking record to impede the benefits that the Commission sought to achieve through its revisions to Rule 2–01 in 2019 and 2020 by maintaining differences between the independence requirements of the Board and the SEC relating to lending arrangements or by not addressing the differences in the definitions of certain terms that appear in the independence rules of both the Commission and the Board.

Specifically, because the PCAOB and the SEC both have jurisdiction with respect to auditor independence, it is important for the PCAOB to consider how its independence standards and rules relate to the SEC's requirements. The PCAOB's interim independence standards, as adopted from the AICPA in 2003, cover many of the same topics as Rule 2–01 and the SEC's regulations and the PCAOB's interim independence standards and independence rules have worked together to establish the independence obligations for auditors subject to the Board's jurisdiction.

Amendments to Rule 2–01 adopted by the SEC, however, included amendments to the scope of Rule 2–01(c)(1)(ii) to exclude certain lending arrangements that the SEC did not believe posed a threat to an auditor's objectivity or impartiality. The Commission also adopted targeted amendments to the definitions of the terms "affiliate of the audit client," "audit and professional engagement period," and "investment company complex," as used in Rule 2–01(f).

To avoid differences and duplicative requirements, the Board adopted targeted amendments to its interim independence standards applicable to lending arrangements between auditors and audit clients. These amendments deleted the independence criteria that relate to lending arrangements under ET §§ 101.02 and 101.07, as well as under ET §§ 191.150–.151, ET §§ 191.182–.183, ET §§ 191.196–.197 and ET §§ 191.220–.221, and thereby eliminated inconsistent requirements under the Board's interim independence standards and the SEC's independence rules and guidance. In addition, the Board adopted targeted amendments to its independence rules to align the definitions of "affiliate of the audit client," "audit and professional engagement period," and "investment company complex" with the SEC's amendments to the definitions of the same terms in Rule 2–01(f). These amendments avoid the potential confusion that might arise if these terms were used in both the SEC's and the PCAOB's independence rules, but defined differently in Rule 2–01(f) and Rule 3501.

#### Baseline

The Board evaluated potential benefits, costs, and unintended consequences of the Board's amendments relative to a baseline that includes the amendments to Rule 2–01 adopted by the SEC in 2019 and 2020. In other words, the baseline assumes that the amendments that the SEC adopted in 2020 to Rule 2–01 have become effective.

In identifying the baseline, the Board gave consideration to the existing framework of independence requirements as well as the parties that would be affected by the Board's amendments. The existing framework of independence requirements applicable to engagements performed by registered public accounting firms and their associated persons is described in section A and includes the Board's interim independence standards, the Board's permanent independence rules (including Rules 3501 and 3502 and

Rules 3520 through 3526), and the SEC's independence rules and guidance. In addition, the Board's quality control standards require firms to establish policies and procedures to provide reasonable assurance that firm personnel maintain independence, both in fact and appearance, in all required circumstances.<sup>42</sup> This framework, including the amendments to Rule 2–01 adopted by the SEC in 2019 and 2020, provides the baseline against which the impacts of the Board's amendments can be considered.

With respect to the affected parties, the Board took note of the SEC's analysis of the parties that would be affected by the SEC's amendments to Rule 2–01 in the 2019 Adopting Release and the 2020 Adopting Release. The SEC observed that the amendments will affect auditors, audit clients, institutions engaging in financing transactions with audit firms and their partners and employees, current or potential affiliates of audit clients, and "covered persons" of accounting firms and their immediate family members, and will affect investors indirectly.<sup>43</sup> The Board's amendments are expected to affect the same parties.

Due to limitations on the data available, the SEC was unable to estimate precisely the number of audit engagements, the number of lenders, or the number of covered persons and their immediate family members that would be immediately affected by the SEC's amendments.<sup>44</sup> Instead, the SEC estimated the potential universe of auditors that might be impacted by the amendments, and reported that 1,729 audit firms were registered with the PCAOB as of August 3, 2020.<sup>45</sup> The SEC also estimated that approximately 6,792 issuers filing on domestic forms and 849 FPIs filing on foreign forms would be affected by the SEC's amendments.<sup>46</sup> In addition:

- For the SEC's amendments to the Loan Provision, the Commission focused mainly on the investment management industry and provided statistics on audited fund series and their investment company auditors.<sup>47</sup>
- For the SEC's amendment related to the "look-back" period for assessing independence compliance with respect to first-time filers, the Commission examined historical data for domestic IPOs and reported that there were

<sup>42</sup> See QC § 20.09, System of Quality Control for a CPA Firm's Accounting and Auditing Practice.

<sup>43</sup> See 2019 Adopting Release at 84 FR 32054; 2020 Adopting Release at 86.

<sup>44</sup> See *id.*

<sup>45</sup> See 2020 Adopting Release at 87.

<sup>46</sup> See *id.*

<sup>47</sup> See 2019 Adopting Release at 84 FR 32054–55.

approximately 543 domestic IPOs between January 1, 2017 and December 31, 2019.<sup>48</sup>

- For the SEC's amendments to the "investment company complex" definition, the Commission focused on registered investment companies and unregistered funds. The SEC reported that, as of September 2020, there were 2,763 registered investment companies that filed annual reports on Form N-CEN. It also reported the numbers and total net assets of mutual funds, exchange traded funds, closed-end funds, variable annuity separate accounts, money market funds, and business development companies as of July 2020.<sup>49</sup>

The above estimates and statistics regarding the parties immediately affected by the SEC's amendments are also relevant to the Board's related amendments. Specifically, the Board's amendments are intended to align the Board's interim independence standards relating to lending arrangements with the independence criteria presented in Rule 2-01 and to align the meaning of the definitions of certain terms used in the independence rules of the SEC and the PCAOB.

#### Consideration of Benefits, Costs, and Unintended Consequences

This section discusses the potential benefits, costs, and unintended consequences of the Board's amendments. The analysis is largely qualitative in nature because the Board is unable to quantify the economic effects due to a lack of information necessary to provide reasonable estimates. Similar to the SEC, the Board is not able to reasonably estimate the number of current audit engagements that will be immediately affected by the amendments as we lack relevant data about such engagements. The Board also similarly does not have precise data on audit clients' ownership and control structures.<sup>50</sup>

#### Benefits

The Board's amendments avoid differences between the independence requirements of the PCAOB and the SEC by deleting the portions of the interim independence standards relating to lending arrangements and aligning the meaning of certain definitions used in the independence rules of the SEC and the PCAOB. The amendments should thus clarify the professional obligations of auditors and avoid regulatory uncertainty regarding the treatment of

lending arrangements and the meaning of certain terms used in the independence requirements of both the SEC and the PCAOB, leading to a potential reduction in overall compliance costs. In amending the Board's independence requirements, the Board also took note of certain of the potential benefits identified by the Commission when amending Rule 2-01 in 2019 and 2020.<sup>51</sup>

- For example, the SEC stated in the 2019 Adopting Release and the 2020 Adopting Release that its amendments to Rule 2-01 may reduce compliance costs for audit firms and audit clients by updating existing requirements that may be unduly burdensome. The SEC also observed that, under the amended rules, auditors and their clients will be able to focus their attention and resources on monitoring those relationships and services that pose the greatest risk to auditor independence, thus reducing overall compliance burdens without significantly diminishing investor protections.<sup>52</sup>

- The SEC observed that the amendments to Rule 2-01 may lead to a potentially larger pool of auditors eligible to perform audit engagements, which in turn could reduce the costs associated with searching for an independent auditor and reduce the costs resulting from switching from one audit firm to another. In this regard, the Commission further stated that an expanded pool of eligible auditors also might improve matching between auditor expertise and necessary audit procedures and considerations for a particular audit client, which could lead to improvements in audit quality and financial reporting quality, as well as improvements in the efficiency of auditing processes. If the amendments lead to improvements in financial reporting quality, investors might be positioned to make more efficient investment decisions.<sup>53</sup>

- The SEC stated that auditors also could benefit from potentially having a broader spectrum of audit clients and clients for non-audit services as a result of the SEC's amendments to Rule 2-01. For example, the Commission observed that if the amendments reduce certain burdensome constraints on auditors in complying with the independence requirements, auditors likely will incur fewer compliance costs. Another example was the Commission's observation that the amendments

potentially could reduce auditor turnover due to changes in audit clients' organizational structure arising from certain merger and acquisition activities.<sup>54</sup>

- The Commission's 2019 Adopting Release and the 2020 Adopting Release also discuss the expected benefits of each of the specific amendments to Rule 2-01 adopted by the Commission. For example, the SEC stated that its amendments to Rule 2-01(c)(1)(ii) to permit some covered persons to be considered independent notwithstanding the existence of certain lending relationships, such as student and consumer loans satisfying the criteria set forth in Rule 2-01, might lead to improved matching between partner and staff experience and audit engagements and, therefore, to increases in audit efficiency and audit quality.<sup>55</sup> Another example was the Commission's observation that the amendment to the definition of "audit and professional engagement period" in Rule 2-01(f)(5), such that the one-year look back provision applies to all first-time filers, domestic and foreign, might avoid the need for a domestic first-time filer to delay an IPO or switch to a different auditor to comply with independence requirements.<sup>56</sup>

To the extent they eliminate potential conflicts with Rule 2-01, as amended, the Board's amendments to its interim independence standards regarding lending arrangements increase the likelihood that the benefits anticipated by the SEC will be realized. In addition, the Board's amendments to align the definitions of "affiliate of the audit client," "audit and professional engagement period," and "investment company complex" with the SEC's amendments avoid the potential compliance costs of having to apply different definitions of the same terms when complying with the independence rules of the SEC and the PCAOB.

#### Costs and Unintended Consequences

The Board also considered the potential costs and unintended consequences of the amendments to its interim independence standards and independence rules. Overall, the Board does not anticipate that the amendments are likely to impose significant incremental compliance costs on audit firms and audit clients, or give rise to unintended consequences, since the amendments are limited in nature and audit firms are expected to revise their independence policies and procedures

<sup>51</sup> See generally 2019 Adopting Release at 84 FR 32055-56; 2020 Adopting Release at 89-92.

<sup>52</sup> See 2020 Adopting Release at 89.

<sup>53</sup> See 2019 Adopting Release at 84 FR 32055; 2020 Adopting Release at 95-96.

<sup>54</sup> See 2020 Adopting Release at 91.

<sup>55</sup> See *id.* at 103-04.

<sup>56</sup> See *id.* at 101.

<sup>48</sup> See 2020 Adopting Release at 88.

<sup>49</sup> See *id.* at 88-89.

<sup>50</sup> See *id.* at 86.

to take into account the SEC's amendments to Rule 2-01 in 2019 and 2020.

In evaluating the potential costs and unintended consequences of the Board's amendments, the Board also took note of the SEC's analysis of the potential costs and other consequences associated with its amendments to Rule 2-01 in the 2019 Adopting Release and the 2020 Adopting Release. For example, in adopting amendments to Rule 2-01 in 2020, the SEC stated that, if the amendments to Rule 2-01 result in an increased risk to auditor objectivity and impartiality due to newly permissible relationships and services, then investors might have less confidence in the quality of financial reporting, which could lead to less efficient investment allocations and increased cost of capital.<sup>57</sup> The Commission also observed, however, that it did not anticipate significant costs to investors or other market participants associated with the amendments because they address relationships and services that are less likely to threaten auditors' objectivity and impartiality.<sup>58</sup>

The Commission further observed in the 2019 Adopting Release and the 2020 Adopting Release that its updates to Rule 2-01 might require more efforts from auditors and audit clients to familiarize themselves with the SEC's amended requirements. For example, the Commission observed in the 2019 Adopting Release that its revisions to the Loan Provision might require the exercise of more judgment in independence determinations, thus potentially contributing to increases in compliance costs in the short term.<sup>59</sup> However, the Commission also stated that it did not anticipate that its amendments to the Loan Provision in 2019 would impose significant compliance costs on auditors.<sup>60</sup> The Commission similarly observed in the 2020 Adopting Release that certain of its amendments to Rule 2-01 earlier this year, such as the inclusion of a dual materiality threshold in the "affiliate of the audit client" and "investment company complex" definitions in Rules 2-01(f)(4) and 2-01(f)(14), might require more efforts from audit firms and audit clients to familiarize themselves with and apply the amended requirements, but that it did not anticipate significant incremental compliance costs.<sup>61</sup>

The Board also took note of the Commission's observation in the 2019

Adopting Release and the 2020 Adopting Release that the SEC's updates to Rule 2-01 could result in some crowding-out effect in the audit industry. For example, the SEC stated in the 2019 Adopting Release that the potentially increased ability of larger firms to compete for audit clients under the amendments to Rule 2-01 adopted by the SEC in 2019 could potentially crowd out smaller audit firms, but also estimated that four audit firms already performed 86% of audits in the investment management industry.<sup>62</sup> In addition, the Commission observed in the 2020 Adopting Release that the larger accounting firms may be more likely to be positively affected by the amendments to Rule 2-01 as these firms may be able to compete for or retain a larger pool of audit clients, which could potentially crowd out the audit business of smaller audit firms.<sup>63</sup> The SEC estimated that the four largest accounting firms already performed 49.2% of audits for all registrants and more than 80% of audits in the registered investment company space and, as a result, it did not expect any potential change in the competitive dynamics among accounting firms to be significant.<sup>64</sup>

#### Alternatives Considered

The Board considered three alternatives to the amendments to its interim independence standards and independence rules described herein: (1) Making amendments to its interim independence standards and independence rules to track the language of the SEC's amendments to Rule 2-01 as closely as possible; (2) issuing guidance relating to compliance with the independence requirements of the PCAOB and the SEC following the Commission's amendments to Rule 2-01 in 2020; or (3) taking no action.

First, the Board considered making specific amendments to its interim independence standards to track the language of the SEC's amendments to Rule 2-01 as closely as possible. This alternative would have maintained duplicative and overlapping requirements relating to lending arrangements under ET § 101.02 and ET § 101.07, as well as under ET §§ 191.150–.151, ET §§ 191.182–.183, ET §§ 191.196–.197, and ET §§ 191.220–.221, in the Board's interim independence standards established by the AICPA. This approach also would have been more challenging from a drafting perspective, especially with

respect to potential amendments to the provisions of the Board's interim independence standards relating to grandfathered and permitted loans, since the Board's interim independence standards use different terminology and have a different organizational structure than Rule 2-01. As a result, this alternative would have provided less clarification to auditors on their professional obligations with respect to lending arrangements than the approach adopted by the Board, which eliminates duplicative and overlapping requirements relating to lending arrangements under the Board's interim independence standards.

Under the first alternative, the Board also considered amending the definitions of "affiliate of the audit client" and "investment company complex" in Rules 3501(a)(ii) and (i)(ii), respectively, to track the language of the SEC's amendments to the definitions of the same terms in Rule 2-01 as closely as possible. The Board decided to amend the definitions of "affiliate of the audit client" and "investment company complex" by incorporating by reference the definition of these terms used in Rule 2-01. Amending the definitions to clarify that these terms have the same meaning as defined in Rule 2-01(f) avoids having to repeat the same definitions in the Board's rules. As discussed, however, the Board amended the definition of "audit and professional engagement period" in Rule 3501(a)(iii) to conform to the SEC's amendments to the definition of "audit and professional engagement period" in Rule 2-01(f)(5) by adapting the Commission's definition and using specific terms used in the Act and other rules of the Board (specifically, by replacing the term "accountant" with the term "registered public accounting firm").

Second, as an alternative to rulemaking, the Board considered the issuance of guidance to inform auditors that, after the effective date of the SEC's 2020 amendments to Rule 2-01, the Board would not object if auditors looked to the requirements of Rule 2-01, as amended, when complying with the independence requirements relating to lending arrangements under the Board's interim independence standards and applying the definitions set forth in Rule 3501(a)(ii), (a)(iii) and (i)(ii). This alternative could be accomplished relatively quickly and would avoid the need for the Board to amend the Board's interim independence standards or Rule 3501. This approach would leave in place, however, provisions of the Board's interim independence standards relating to lending arrangements and definitions of certain terms in Rule 3501

<sup>57</sup> See *id.* at 92.

<sup>58</sup> See *id.*

<sup>59</sup> See 2019 Adopting Release at 84 FR 32056–57.

<sup>60</sup> See *id.* at 84 FR 32056.

<sup>61</sup> See 2020 Adopting Release at 97, 99–100.

<sup>62</sup> See 2019 Adopting Release at 84 FR 32057.

<sup>63</sup> See 2020 Adopting Release at 108–09.

<sup>64</sup> See *id.* at 109.

that include differences with Rule 2–01, as amended, or otherwise overlap with the SEC’s independence requirements relating to lending arrangements. This approach might also create regulatory uncertainty and additional costs by leaving auditors and audit clients, especially those who were not aware of the Board’s guidance, uncertain as to their professional obligations.

Third, the Board considered taking no action at this time to amend its interim independence standards or independence rules. This alternative would require auditors to comply with two different sets of independence requirements relating to lending arrangements under Rule 2–01 and the Board’s interim independence standards<sup>65</sup> and to look to two different definitions of “affiliate of the audit client,” “audit and professional engagement period,” and “investment company complex” when complying with the independence rules of the SEC and the PCAOB. While this approach might underscore the Board’s authority to establish independence standards for registered public accounting firms, it would leave unaddressed certain differences between the independence requirements of the Board and the SEC that had not existed when the PCAOB adopted its interim independence standards in 2003 or began to adopt its permanent independence rules in 2005, including with respect to both lending arrangements and the scope of the entities considered part of the “audit client” for purposes of the Board’s independence rules. This approach might also impede some of the benefits that the Commission sought to achieve through its revisions to Rule 2–01 and result in additional compliance costs when applying two different definitions of the same terms in Rule 2–01 and the Board’s rules.

In comparison to these alternatives, the Board’s decision to remove the provisions relating to lending arrangements from the Board’s interim independence standards avoids duplicative requirements in the independence requirements of the Board and the SEC on lending arrangements and helps facilitate compliance with Rule 2–01, as amended, by clarifying the professional obligations of audit firms. The amendments should also facilitate cooperation and coordination between the Board and the SEC when monitoring compliance with the SEC’s revised provisions in Rule 2–01(c)(1)(ii) relating to lending arrangements.

<sup>65</sup> See *supra* note 15 (discussing the Note to Rule 3500T).

#### Application to Audits of Emerging Growth Companies

Pursuant to Section 104 of the Jumpstart Our Business Startups Act (“JOBS Act”), rules adopted by the Board subsequent to April 5, 2012 generally do not apply to the audits of EGCs, as defined in Section 3(a)(8) of the Securities Exchange Act of 1934, unless the SEC “determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.”<sup>66</sup> As a result of the JOBS Act, the rules and related amendments to PCAOB standards the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

To inform consideration of the application of the Board’s rules and standards to audits of EGCs, the Board’s staff publishes a white paper that provides general information about characteristics of EGCs.<sup>67</sup> As of the November 15, 2019 measurement date, the PCAOB staff identified 1,761 companies that had identified themselves as EGCs and had filed audited financial statements with the SEC, including an audit report signed by a registered public accounting firm in the 18 months preceding the measurement date.

In amending Rule 2–01 in 2019 and 2020, the Commission conducted an economic analysis, which included an analysis of the effect of the amendments to Rule 2–01 on efficiency, competition, and capital formation. The SEC concluded that the amendments to Rule 2–01 likely would improve the practical application of Rule 2–01 and reduce compliance burdens, and might increase competition among auditors and lead to a potential reduction in audit costs. In addition, the Commission determined that the amendments to Rule 2–01 may also facilitate capital formation.<sup>68</sup> Additionally, the SEC’s economic

<sup>66</sup> See Public Law 112–106 (Apr. 5, 2012). See Section 103(a)(3)(C) of the Act, as added by Section 104 of the JOBS Act. Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The Board’s amendments do not fall within either of these two categories.

<sup>67</sup> See PCAOB white paper, Characteristics of Emerging Growth Companies and Their Audit Firms as of November 15, 2019 (Nov. 9, 2020), available on the Board’s website.

<sup>68</sup> See 2019 Adopting Release at 84 FR 32057; 2020 Adopting Release at 107.

analysis regarding the amendments to the definition of “audit and professional engagement period” in Rule 2–01(f)(5) concluded that a shorter look-back period may facilitate additional IPOs and thereby promote efficiency and capital formation.

The economic considerations discussed above are generally applicable to audits of EGCs. Moreover, if the Board’s amendments were determined not to apply to the audits of EGCs, auditors would be required to address the differing independence requirements in their independence policies and procedures and in their quality control systems, which would create the potential for confusion.

Accordingly, and for the reasons explained above, the Board requests that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the Board’s targeted amendments to its interim independence standards and independence rules to audits of EGCs. The Board stands ready to assist the Commission in considering any comments the SEC receives on these matter during the Commission’s public comment process.

#### III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period not more than an additional 45 days (i) if the Commission determines that such longer period is appropriate and publishes the reasons for such determination or (ii) as to which the Board consents, the Commission will:

- (A) By order approve or disapprove such proposed rules; or
- (B) institute proceedings to determine whether the proposed rules should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission’s internet comment form (<http://www.sec.gov/rules/pcaob.shtml>); or

• Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number PCAOB–2020–01 on the subject line.

#### Paper Comments

• Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number PCAOB–2020–01. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/pcaob.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without charge. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number PCAOB–2020–01 and should be submitted on or before December 18, 2020.

For the Commission by the Office of the Chief Accountant, by delegated authority.<sup>69</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

[FR Doc. 2020–26145 Filed 11–25–20; 8:45 am]

**BILLING CODE 8011–01–P**

## SECURITIES AND EXCHANGE COMMISSION

### Sunshine Act Meetings

**TIME AND DATE:** 2:00 p.m. on Wednesday, December 2, 2020.

**PLACE:** The meeting will be held via remote means and/or at the Commission's headquarters, 100 F Street NE, Washington, DC 20549.

**STATUS:** This meeting will be closed to the public.

#### MATTERS TO BE CONSIDERED:

Commissioners, Counsel to the Commissioners, the Secretary to the Commission, and recording secretaries will attend the closed meeting. Certain staff members who have an interest in the matters also may be present.

In the event that the time, date, or location of this meeting changes, an announcement of the change, along with the new time, date, and/or place of the meeting will be posted on the Commission's website at <https://www.sec.gov>.

The General Counsel of the Commission, or his designee, has certified that, in his opinion, one or more of the exemptions set forth in 5 U.S.C. 552b(c)(3), (5), (6), (7), (8), 9(B) and (10) and 17 CFR 200.402(a)(3), (a)(5), (a)(6), (a)(7), (a)(8), (a)(9)(ii) and (a)(10), permit consideration of the scheduled matters at the closed meeting.

The subject matter of the closed meeting will consist of the following topic:

Institution and settlement of injunctive actions;

Institution and settlement of administrative proceedings;

Resolution of litigation claims; and

Other matters relating to enforcement proceedings.

At times, changes in Commission priorities require alterations in the scheduling of meeting agenda items that may consist of adjudicatory, examination, litigation, or regulatory matters.

#### CONTACT PERSON FOR MORE INFORMATION:

For further information; please contact Vanessa A. Countryman from the Office of the Secretary at (202) 551–5400.

Dated: November 24, 2020.

**Vanessa A. Countryman,**

*Secretary.*

[FR Doc. 2020–26316 Filed 11–24–20; 11:15 am]

**BILLING CODE 8011–01–P**

## SOCIAL SECURITY ADMINISTRATION

[Docket No. SSA–2020–0058]

### Agency Information Collection Activities: Proposed Request

The Social Security Administration (SSA) publishes a list of information

collection packages requiring clearance by the Office of Management and Budget (OMB) in compliance with Public Law 104–13, the Paperwork Reduction Act of 1995, effective October 1, 1995. This notice includes revisions of OMB-approved information collections.

SSA is soliciting comments on the accuracy of the agency's burden estimate; the need for the information; its practical utility; ways to enhance its quality, utility, and clarity; and ways to minimize burden on respondents, including the use of automated collection techniques or other forms of information technology. Mail, email, or fax your comments and recommendations on the information collection(s) to the OMB Desk Officer and SSA Reports Clearance Officer at the following addresses or fax numbers.

(OMB) Office of Management and Budget, Attn: Desk Officer for SSA, Fax: 202–395–6974, Email address: [OIRA\\_Submission@omb.eop.gov](mailto:OIRA_Submission@omb.eop.gov).

(SSA) Social Security Administration, OLCA, Attn: Reports Clearance Director, 3100 West High Rise, 6401 Security Blvd., Baltimore, MD 21235, Fax: 410–966–2830, Email address: [OR.Reports.Clearance@ssa.gov](mailto:OR.Reports.Clearance@ssa.gov).

Or you may submit your comments online through [www.regulations.gov](http://www.regulations.gov), referencing Docket ID Number [SSA–2020–0058].

The information collections below are pending at SSA. SSA will submit them to OMB within 60 days from the date of this notice. To be sure we consider your comments, we must receive them no later than January 26, 2021. Individuals can obtain copies of the collection instruments by writing to the above email address.

*1. Partnership Questionnaire—20 CFR 404.1080–404.1082—0960–0025.* SSA considers partnership income in determining entitlement to Social Security benefits. SSA uses information from Form SSA–7104 to determine several aspects of eligibility for benefits, including the accuracy of reported partnership earnings; the veracity of a retirement; and lag earnings where SSA needs this information to determine the status of the insured. The respondents are applicants for, and recipients of, Title II Social Security benefits who are reporting partnership earnings.

*Type of Request:* Revision of an OMB-approved information collection.

<sup>69</sup> 17 CFR 200.30–11(b)(1) and (3).