

GIBSON DUNN



## *SEC Up-Close*

Panelists: Beth Ising  
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Moderator: Henrique Canarim  
November 6, 2018

# Program Agenda

- Overview of Jay Clayton's Agenda for the SEC
- Reform Initiatives to Facilitate Capital Raising
- The SEC's Enforcement Agenda
- Key Topics for the 2019 Proxy Season
- Key Shareholder Voting Issues for the 2019 Proxy Season
- Impact of Court Decisions on the SEC
- Sustainability Disclosures and Shareholder Litigation
- Hot Buttons in SEC Comment Letters
- The SEC's Continued Focus on FCPA
- Shareholder Proposal Trends
- Lessons from the Tesla Case
- Cybersecurity Issues Affecting Public Company Disclosures

# MCLE Certificate Information

- Most participants should anticipate receiving their certificate of attendance in four weeks following the webcast.
- Virginia Bar Association members should anticipate receiving their certificate of attendance in six weeks following the webcast.
- All questions regarding MCLE Information should be directed to Kasha Hunt at ACC, [kasha.hunt-ncr@accglobal.com](mailto:kasha.hunt-ncr@accglobal.com)

# SEC Developments

- **Commissioners**

- ✓ Current commissioners:
  - ❖ Chair Clayton (Independent)
  - ❖ Commissioner Kara Stein (a Democrat whose term expired in June 2017)
  - ❖ Commissioner Robert Jackson (a Democrat whose term expires in 2019)
  - ❖ Commissioner Hester Peirce (a Republican whose term expires in 2020).
- ✓ New Commissioner Elad Roisman was confirmed by the Senate on September 5.
  - ❖ Roisman fills the vacancy left by Commissioner Michael Piwowar's resignation in July 2018.
  - ❖ Roisman is a securities lawyer and former Senate Banking Committee staffer.
- ✓ According to new reports, the Democrats have selected Allison Lee—a securities lawyer and SEC staffer—to be nominated to fill Stein's seat (as Stein can remain in office only until December 2018).

# Capital Formation is a Priority

- Goal: Reverse decline in number of public companies in U.S.
- Congressional action
  - ✓ Jumpstart Our Business Startups Act (the JOBS Act) - 2012
  - ✓ Fix America's Surface Transportation Act (the FAST Act) - 2015
  - ✓ Economic Growth, Regulatory Relief, and Consumer Protection Act - 2018

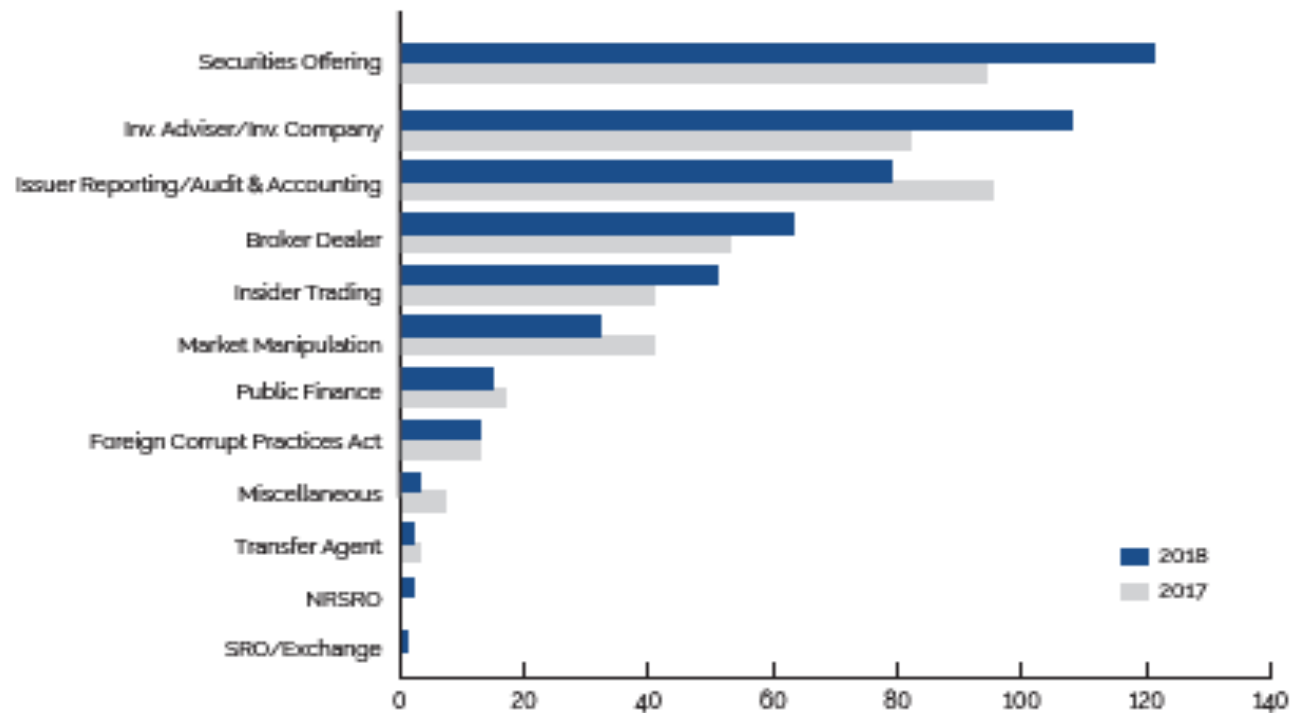
# Capital Formation is a Priority (Cont'd)

- SEC action since Clayton
  - ✓ Recent rule changes related to the scaled disclosure framework for smaller reporting companies
  - ✓ Recent rule changes to simplify certain outdated, overlapping, or duplicative disclosure requirements
  - ✓ Proposed amendments to financial disclosures to encourage guaranteed debt offerings to be conducted on a registered rather than private basis
  - ✓ Permit companies to submit IPO registration statements confidentially and registration statements for offerings within one year of an IPO
  - ✓ Staff policies and practices more practical; Rule 3-13 waivers; comment letters
  - ✓ Seeking “Main Street” investor feedback through local roundtables and website
  - ✓ Strategic Plan for 2018-2022

# Upcoming Rulemaking

- SEC's agenda includes items designed to promote capital formation
  - ✓ Final rulemaking stage
    - ❖ FAST Act - modernization and simplification of Regulation S-K
    - ❖ Continued disclosure update and simplification
  - ✓ Future proposals
    - ❖ Amendments to financial disclosure requirements for acquired businesses (Reg S-X Rule 3-05 and Article 11)
    - ❖ Extending testing-the-waters provisions beyond emerging growth companies
    - ❖ Enhancing effectiveness of business and financial disclosures required by Regulation S-K
    - ❖ Amendments to Form S-8 and Rule 701 for compensatory arrangements
- Chairman Clayton directives
  - ✓ Amend requirements for auditor attestation report under Section 404(b) of SOX
  - ✓ Comprehensive review of exempt offering framework in a concept release
    - ❖ Dodd-Frank Act requires review of accredited investor definition every four years (2019)

# 2018 SEC Division of Enforcement Statistics





# Enforcement Focus on Main Street Investors

- First of five principles guiding enforcement – focus on Main Street Investors
- If conduct impacts “Mr. and Mrs. 401(k)” enforcement actions are more likely and SEC attention increases
- Multiple enforcement actions involving Ponzi schemes
- Establishment of Retail Strategy Task Force
  - ✓ Protect main street investors
  - ✓ Redeployed staff to new task force
  - ✓ Focuses on investment advisor and broker misconduct
  - ✓ Encouraged self-disclosure by advisors regarding expensive mutual fund classes for clients [Share Class Selection Disclosure (SCSD) Initiative]
- Enforcement Actions have begun against investment advisors
- “Scores of investment advisors participated in the SCSD initiative, which will result in charges against them.” SEC Enforcement Division Annual Report 2018, pg., 2

# Proxy Season Developments

- **Increased focus on the “front half” of the proxy statement**
  - ✓ Board skills, selection process, and diversity
  - ✓ Company culture: ESG and employment practices
- **Proliferation of “exempt solicitations”**
  - ✓ PX14A6G filings show up on EDGAR under the subject company’s filings
  - ✓ 162 filings YTD in 2018 vs. 114 in all of 2017 and 95 in all of 2014
  - ✓ SEC Staff issues two C&DI in July 2018
- **Directors compensation in the spotlight**
  - ✓ Frequent subject of shareholder litigation over past several years
  - ✓ Delaware Supreme Court ruling in *In re Investors Bancorp, Inc. Stocholder Litigation* (Del. 2017) may lead to more litigation
  - ✓ Whether to enhance disclosure or seek shareholder approval of directors compensation

# Proxy Season Developments

- **Audit Committee Reports continue to be enhanced**
  - ✓ Center for Audit Quality released its “2018 Audit Committee Transparency Barometer” on November 1
  - ✓ Disclosures regarding the considerations in appointment of outside auditor, role in selection of engagement partner, considerations in evaluating performance
- **Executive compensation issues remain important**
  - ✓ Compensation Committee policies in light of 162(m) amendments
  - ✓ CEO Pay Ratio disclosures were largely a non-event, but compliance issues remain for Year 2
  - ✓ Say-on-Pay fail rate for 2018 is the highest in three years and the percentage of companies receiving more than 90% support is the lowest since 2012

# Institutional Investor Developments

- Glass Lewis 2019 Proxy Voting Policies – additional situations where may recommend “against” votes:
  - ✓ At least on the nominating committee chair if there are no women on the board.
  - ✓ Nominating committee members if seek ratification of special meeting right to exclude shareholder proposal.
  - ✓ Nominating committee members in limited circumstances if exclusion of a shareholder proposal was "detrimental to shareholders."
  - ✓ Directors responsible for ESG oversight (or the audit committee) if have not properly managed ESG risks and it harmed shareholder value.
  - ✓ Nominating committee members if don't provide “effective” disclosure assuring shareholder rights at virtual-only shareholder meetings.
  - ✓ Directors based on company performance but now will look beyond stock price performance to overall governance, pay-for-performance alignment and board responsiveness.
  - ✓ On say-on-pay proposal in certain situations related to front-loaded awards, sign-on and severance arrangements, excise tax gross-ups and discretionary short-term incentives.

# Institutional Investor Developments (Cont'd)

- Commonsense Principles 2.0 – key changes
  - ✓ **Director elections:** “It is a fundamental right of shareholders to elect directors whom they believe are best suited to represent shareholder interests,” and annual director elections “may help promote board accountability to shareholders.”
  - ✓ **Majority voting and failure to receive majority support:** If a director fails to receive a majority vote, the director should offer to resign and the board “ordinarily should accept” the resignation offer.
  - ✓ **Commitment to serve:** Recommend that directors refrain from joining a board if they are not committed to serving for at least three years.
  - ✓ **Director engagement with shareholders:** Acknowledge that on some issues, such as governance and CEO compensation, direct communication from the board may be warranted.
  - ✓ **Proxy access:** Explicitly support the adoption of proxy access, subject to reasonable requirements that do not make proxy access unduly burdensome for significant, long-term shareholders.

# Institutional Investor Developments (Cont'd)

- Commonsense Principles 2.0 – cont'd
  - ✓ **Poison pills and other anti-takeover measures:** Discourages adoption of poison pills and other anti-takeover measures and states that if such measures are adopted, they should be put to a shareholder vote and subject to periodic review to determine whether they remain appropriate.
  - ✓ **Non-GAAP measures:** When non-GAAP measures are used in corporate reporting, companies “should provide a bridge” from non-GAAP to GAAP results, “so as not to obscure GAAP results.”
  - ✓ **Independent board leadership:** Emphasize the importance of independent board leadership and acknowledge that there are two common leadership structures in the United States: an independent chair and a non-independent chair with a lead independent director.
  - ✓ **Large special compensation awards:** Clarifies that large, non-recurring special awards or special retention awards should be “carefully evaluated and reserved for special circumstances.”

## Institutional Investor Developments (Cont'd)

- **Morrow Sodali Survey.** According to Morrow Sodali's 2018 Institutional Investor Survey, institutional investors are seeking from their portfolio companies: (1) a clear articulation of and additional disclosures regarding the company's business strategy and goals; (2) information about board composition that enables investors to evaluate the suitability of individual directors; and (3) an explanation of the business rationale for board decisions and how they align with the company's strategy and performance.
- **E&Y Survey.** According to a February 2018 report by E&Y based on a survey of 60 institutional investors and advisers, those investors are focused on: (1) board composition, with a particular focus on enhanced board diversity; (2) board expertise that is aligned with the company's business goals; (3) increased focus on and disclosure regarding the materiality to the company of climate risk and environmental matters; (4) enhanced board oversight of workforce management/human capital issues; and (5) alignment of executive compensation with company performance and strategy.

# Court Cases Affecting SEC Enforcement

- *Digital Realty Trust, Inc. v. Somers*, 583 U.S. \_\_\_\_ (Feb. 21, 2018)
  - ✓ The anti-retaliation provision of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act does not extend to an individual who has not reported a violation of the securities laws to the Securities and Exchange Commission.
- *Kokesh v. Securities and Exchange Commission*, 581 U.S. \_\_\_\_ (June 5, 2017)
  - ✓ Because disgorgement sought by the Securities and Exchange Commission operates as a penalty, in that it is imposed by the courts as a consequence for violating public laws and for punitive purposes, any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued.
- *Lucia v. Securities and Exchange Commission*, 585 U.S. \_\_\_\_ (June 21, 2018)
  - ✓ Securities and Exchange Commission administrative law judges are “officers of the United States,” subject to the Constitution’s appointments clause, and therefore can be appointed only by the President, a court of law, or a head of department.



# Whistleblowers

- Since 2011, SEC awarded over \$300 million
- Impact of Digital Realty
  - ✓ Supreme Court held that whistleblowers must report alleged misconduct to the SEC before they can sue under the Dodd-Frank Act's anti-retaliation provision
  - ✓ Likely will lead to more employees reporting to SEC rather than internally
  - ✓ Emphasizes importance of encouraging internal reporting
- Less enforcement of cases alleging employers impeding reporting potential misconduct to SEC
- Proposed rules regarding the size of whistleblower awards and allowing awards based on DPAs and NPAs

# ESG Disclosures – Basis for Liability

- Existing liability regime applies to ESG disclosures in SEC filings (including hyperlinked materials) and other statements to investors.
  - ✓ For example, under Sections 11 and 12(a)(2) of the Securities Act of 1933, companies may be strictly liable for material misstatements made in connection with securities offerings, like statements in registration statements and prospectuses.
  - ✓ Additionally, public company CEOs and CFOs—who are required to certify quarterly and annual reports filed with the SEC—could face “control person” liability under Section 20(a) of the Exchange Act if ESG disclosures included or hyperlinked in those filings are not accurate.
- But even ESG disclosures outside of SEC filings – for example, on websites and in voluntary disclosures (like sustainability reports) – can pose liability risks.
  - ✓ For example, Section 10(b) of the Exchange Act and SEC Rule 10b-5, the anti-fraud provision of the federal securities laws, apply more broadly, creating liability for fraudulent statements made to investors even if the statements were made outside of SEC filings.

# ESG Disclosures – Evolving Case Law

- Thus far, most federal securities class actions arising from public ESG disclosures have been brought under Sections 10(b) and 20(a) of the Exchange Act.
  - ✓ Often, these suits follow large industrial accidents or a significant stock price drop.
- Results in these cases have been mixed, but a few early motion-to-dismiss decisions are instructive regarding how courts analyze ESG disclosures.
- Generally, decisions have turned on whether the ESG disclosures at issue were sufficiently concrete and measurable to form the basis for a misrepresentation claim.
- Examples of 10(b) claims involving ESG statements outside of SEC filings that survived a motion to dismiss include:
  - ✓ BP – actionable statements included BP’s assertions that its safety operations management system “covers all aspects of our operations,” when it allegedly did not apply to contractor-owned sites.
  - ✓ Massey Energy – actionable statements included claims that safety was the ‘first priority every day’ at Massey,” that it was an “industry leader in safety,” and that “safety at its mines [was] improving,” which were contradicted by safety violation records and a comparison of the accident and fatality rates in the mines at issue to the national average.

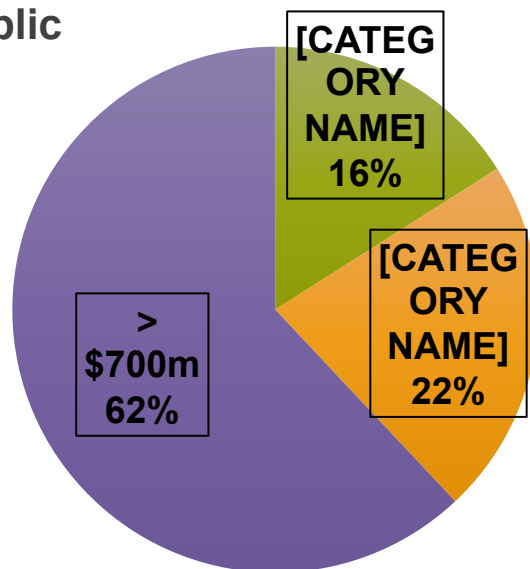
# ESG Disclosures – Best Practices

1. Check the Facts
2. Encourage Appropriate Internal Collaboration
3. Use Aspirational Language and Estimates
4. Include Disclaimers
5. Understand that Location and Prominence Matter
6. Educate Internally on Litigation and Related Trends

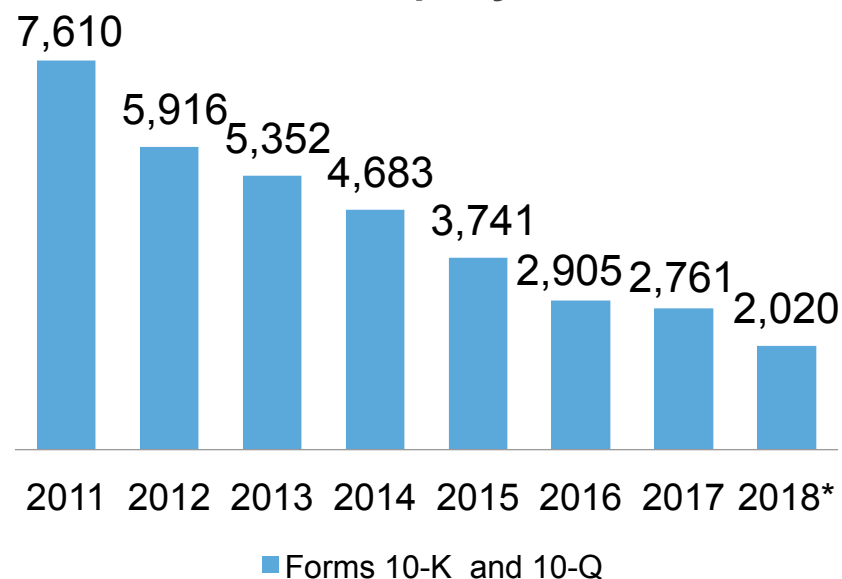
# SEC Reviews/Comments (Cont'd)

**Companies receiving comment letters by size**

Public



**Number of SEC staff comment letters per year**



**Source:** Audit Analytics — SEC UPLOAD comment letters issued related to Forms 10-K and 10-Q for the 12-month periods ended June 30, 2011 through 2018.

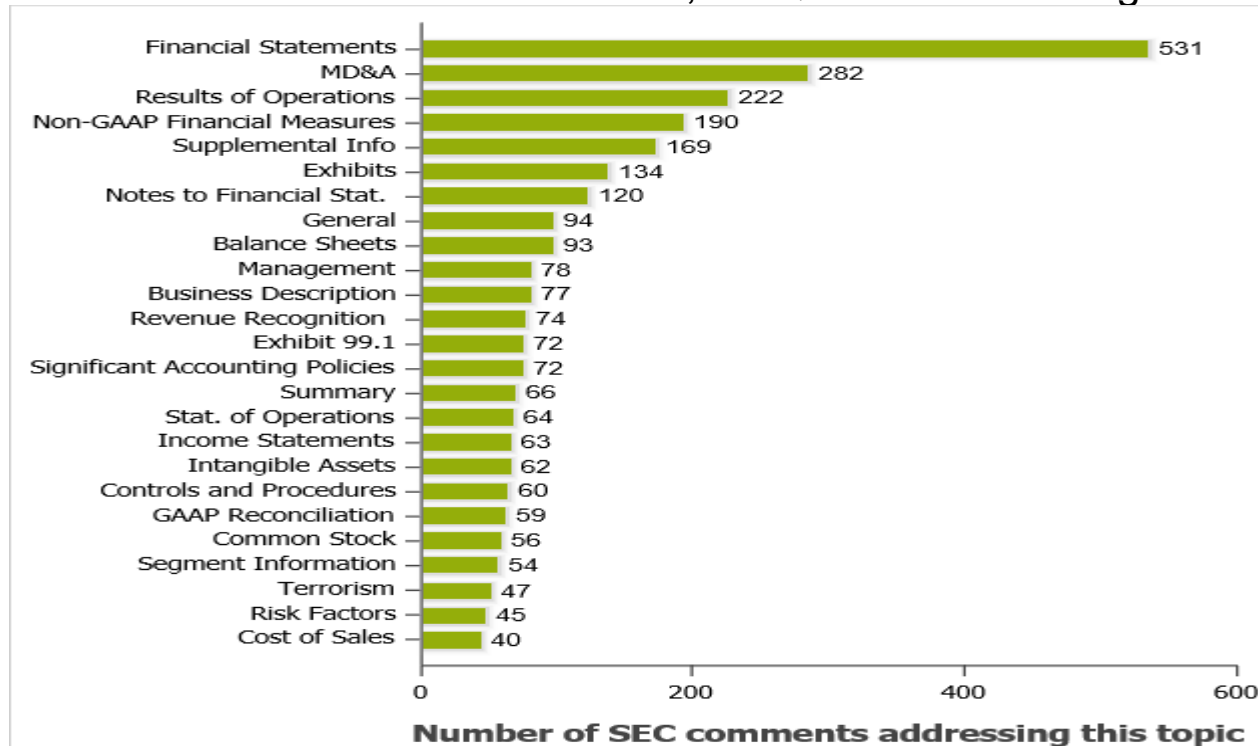
\* The SEC staff publicly releases comment letters no earlier than 20 business days after completion of its review. Therefore, some letters for the 12-month period ended June 30, 2018 may not yet be publicly available.

# SEC Reviews/Comments

Comment letter topic	Ranking	
	2017	2016
Non-GAAP financial measures	1	2
Management's discussion and analysis (MD&A)	2	1
Fair value measurements	3	3
Segment reporting	4	5
Revenue recognition	5	4
Intangible assets and goodwill	6	7
Income taxes	7	6
State sponsors of terrorism	8	17
Acquisitions and business combinations	9	8
Executive compensation	10	11

# SEC Reviews/Comments

- 1280 comment letters issued on 10-Ks, 10-Qs and 8-Ks through 10/31/18



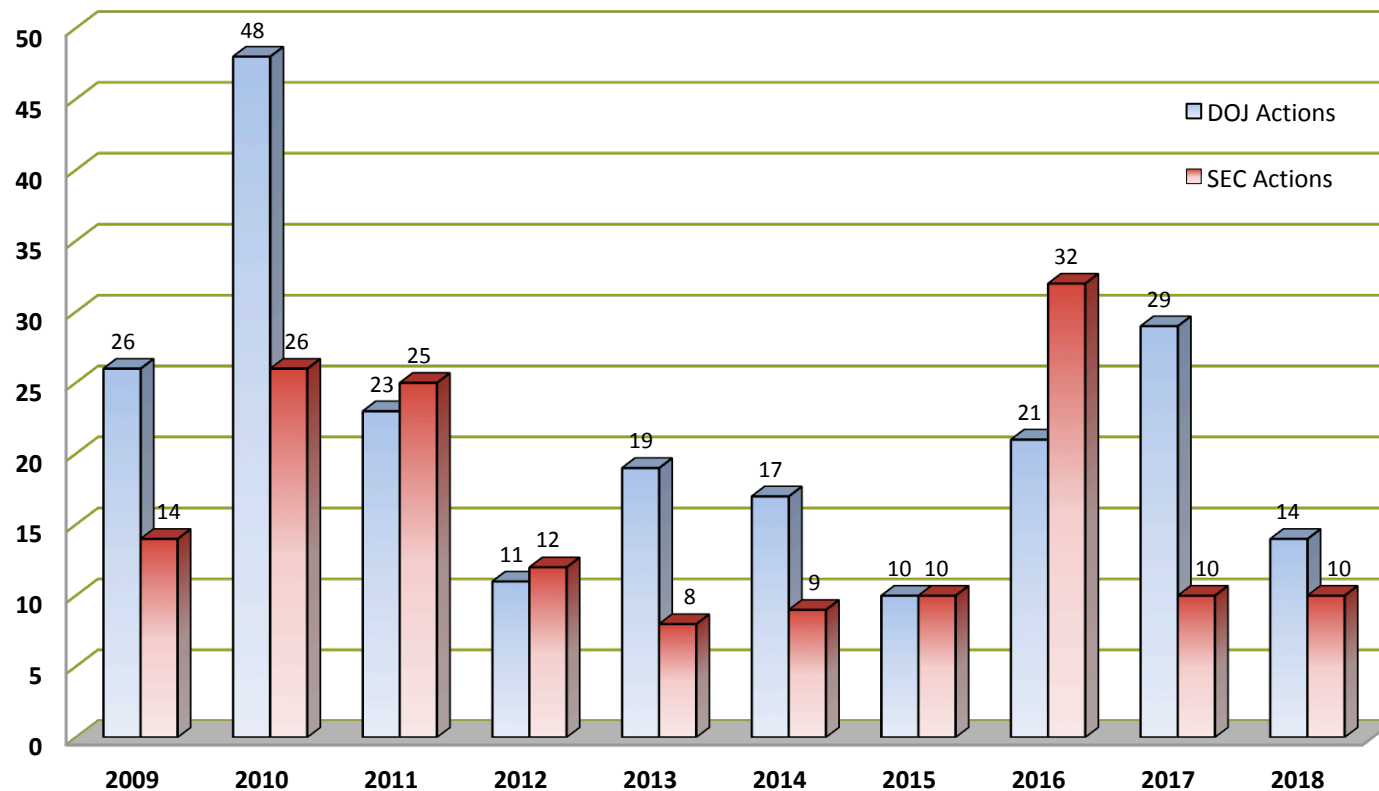
Source: Intelligize

# FCPA

- “Enforcement of the Foreign Corrupt Practices Act (FCPA) continues to be a high priority area for the SEC.” <https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml>
- Strong encouragement of voluntary disclosure
- Greater coordination with foreign authorities
- Focus on individuals
- Issuers expected to:
  - ✓ appropriately tailored and resourced FCPA compliance programs,
  - ✓ establish appropriate controls over higher risk third-parties,
  - ✓ engage in anti-bribery due diligence during acquisitions, and
  - ✓ periodically audit and review program to deal with changing risks

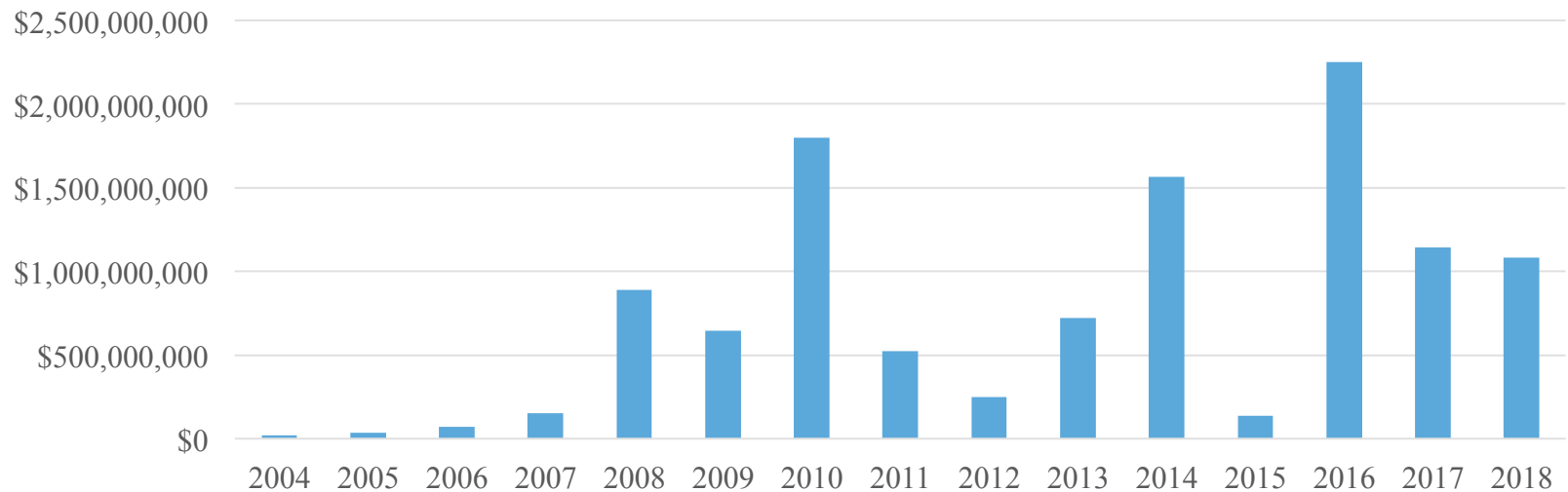


# FCPA Enforcement Actions Per Year (2009 to Present\*)



# FCPA Monetary Resolutions (2004 to Present\*)

Total Value of Corporate FCPA Monetary Resolutions



# Shareholder Proposals in 2018

- Fewer Proposals but Higher Votes.** Shareholders submitted 788 proposals during the 2018 proxy season,\* down 5% from the 827 proposals submitted during the 2017 proxy season and 14% from the 916 proposals submitted during the 2016 proxy season. The average support, however, increased by almost 4 percentage points.



Top Proposal Topics by Number Submitted	
2017	2018
Proxy access (112)	<b>Political contributions &amp; lobbying expenditures (85)</b>
Political contributions & lobbying expenditures (87)	<b>Shareholder special meeting rights (75)</b>
Climate change (69)	<b>Climate change (72)</b>
Anti-discrimination & diversity (69)	<b>Anti-discrimination &amp; diversity (68)</b>
Independent chair (47)	<b>Independent chair (51)</b>

\* For purposes of reporting statistics regarding shareholder proposals, references to the “2018 proxy season” refer to the period between October 1, 2017, and June 1, 2018. References to the “2017 proxy season” refer to the comparable periods in 2017. All data is derived from the ISS databases as of June 1, 2018 and June 1, 2017 for the 2018 and 2017 annual meetings, respectively.

## Shareholder Proposals in 2018 (Cont'd)

- **Continued Focus on ESG Issues.** Across five broad categories of shareholder proposals in 2018, social and environmental proposals continued to be the most frequently submitted proposals (representing 43% of all proposals submitted), followed by governance proposals (36%), corporate civic engagement proposals (12%), executive compensation proposals (7%), and other proposals (2%).
  - ✓ **E&S Proposals.** Institutional investors in particular are focusing on social and environmental issues, with a majority of top global institutional investors now considering such issues in their proxy voting and engaging with companies on such matters. Key topics covered by this category this year again include climate change-related and anti-discrimination- and diversity-related proposals.
  - ✓ **Governance Proposals.** Governance issues appear to be slightly less of a focus as formerly contested issues (annual director elections, majority voting standard, supermajority voting provisions and, most importantly, proxy access) have become more standard among large companies, although there was an increase in special meeting and independent chair proposals during this proxy season.

# Shareholder Proposals in 2018 (Cont'd)

- **2017-2018 Staff Guidance.** Guidance from the SEC staff provides additional potential avenues for companies to exclude certain shareholder proposals under the ordinary business and economic relevance exceptions.
  - ✓ In Staff Legal Bulletin No. 14I, the Staff indicated that it will consider a board of directors' analysis included in a no-action request and thus may agree with excluding proposals that to date have not been excludable.
  - ✓ To exclude a proposal as relating to ordinary business, the board's analysis must demonstrate why the proposal relates to ordinary business matters and does not raise a significant policy issue at the company.
  - ✓ To exclude a proposal as not economically relevant, the board's analysis must demonstrate that the proposal deals with a matter that is not significantly related to the company's business (and the proposal must otherwise relate to operations that account for less than 5% of total assets, net earnings and gross sales).
  - ✓ During the 2018 proxy season, the Staff granted only 1 no-action request based on a board's analysis but indicated that was due in part to the Staff and companies figuring out when the necessary burden would be met.
  - ✓ Clarified board analysis in Staff Legal Bulletin No. 14J.

# Cyber Security

- 2017: Cyber unit created in Division of Enforcement focused on:
  - ✓ Market manipulation schemes involving false information spread through electronic and social media
  - ✓ Hacking to obtain material nonpublic information
  - ✓ Violations involving distributed ledger technology and initial coin offerings
  - ✓ Misconduct perpetrated using the dark web
  - ✓ Intrusions into retail brokerage accounts
  - ✓ Cyber-related threats to trading platforms and other critical market infrastructure

## Cyber Security (Cont'd)

- 2018: SEC Guidance regarding disclosure obligations (Feb. 26, 2018)
- 2018: SEC Section 21(a) report (October 16, 2018)
  - ❖ Nine publicly companies defrauded of \$100 million through cyber fraud
  - ❖ No enforcement actions but SEC stressed that:
    - Internal controls requirements of federal securities laws require issuers to have in place appropriate internal controls “attuned to this kind of cyber-related fraud” and “those controls will be reviewed and updated as circumstances warrant.”
    - Not every cyber breach will result in enforcement action

# Cyber Security (Cont'd)

- Recent Enforcement Actions
  - ✓ Altaba (formerly Yahoo!)
    - ❖ Focused on late response and inadequate procedures
    - ❖ \$35 million penalty
  - ✓ Voya Financial Advisors Inc.
    - ❖ SEC alleged investment adviser had failures in cybersecurity policies and procedures surrounding a cyber intrusion that compromised personal information of thousands of customers
    - ❖ \$1 million penalty
  - ✓ 225 cyber-related investigations ongoing SEC Enforcement Division Annual Report 2018, pg., 7
  - ✓ Expect more enforcement actions



# Additional Materials and Background

Visit our blog, the *Gibson Dunn Securities Regulation and Corporate Governance Monitor*, at <https://securitiesregulationmonitor.com>

The screenshot shows the homepage of the Gibson Dunn Securities Regulation and Corporate Governance Monitor. The header features the firm's name "GIBSON DUNN" in white on a dark red background, followed by the site title "Securities Regulation and Corporate Governance Monitor" in white. Below the header is a blue navigation bar with links: Home, About Us, Contact Us, Email Subscription (with a mail icon), and Sign In. The main content area has a red banner for the article "Commonsense Principles 2.0 Released" dated 10/24/2018, posted by Elizabeth Ising, Lori Zyskowski, and Gillian McPhee. The article text discusses the release of the Commonsense Principles 2.0 on October 18, 2018, and mentions the involvement of 13 business and investment leaders. A sidebar on the right contains a search bar, an RSS feed link, and a list of topics including Audit Committee, Compensation Committee, Corporate Governance, Dodd Frank, EU Regulation, Executive Compensation, FCPA, India Regulation, and Investment Act/Investment. At the bottom of the article, there are links to "Share/Print" and "Send comment to Editor".

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**Commonsense Principles 2.0 Released**  
10/24/2018 | Posted by Elizabeth Ising; Lori Zyskowski; Gillian McPhee  
Topic: Corporate Governance ; Shareholder Proposals ; Proxy Access

On October 18, 2018, the Commonsense Principles 2.0 (the "Principles 2.0") were released. They are an update to the Commonsense Principles of Corporate Governance (the "Previous Principles") developed in 2016 by a group of 13 business and investment leaders, including representatives of Berkshire Hathaway, BlackRock and State Street and the chief executive officers of several large public companies, available [here](#), and discussed in a previous [client alert](#).

An Open Letter accompanying the Principles 2.0 observes that in recent years, a number of other groups have issued their own statements on corporate governance, including the Investor Stewardship Group and Business Roundtable. These statements, which are aimed in part at addressing "unhealthy short-termism," are also part of a broader effort to foster engagement among companies, boards and investors. The signatories to the Principles 2.0 express their hope that ultimately, the many sets of corporate governance principles currently in circulation can be harmonized and consolidated, and reflect the combined views of companies and investors.

The 21 signatories to the Principles 2.0 include representatives of additional public companies and institutional investors such as AT&T, Coca-Cola, IBM, Johnson &...

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**ISS Proposes and Opens Comment Period on Board Diversity and Pay-for-Performance Policy Changes**

Current thoughts on development and trends in securities regulation, corporate governance and executive compensation published by Gibson Dunn.

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# Regulatory Reform for the Capital Markets: Relief from Certain Financial Statement Requirements

- Under S-X Rule 3-13: Ask the SEC staff to modify or waive their SEC financial reporting obligations, based on the facts and circumstances, if such actions are consistent with investor protection
  - ✓ Consider requesting relief when Regulation S-X requires disclosures that are burdensome to generate but may not be material to the total mix of information available to investors
  - ✓ Registrants must make a written request to the SEC staff, unless relief is self-executing according to the Financial Reporting Manual (FRM)
  - ✓ Otherwise, taking relief constitutes non-compliance with SEC rules
- SEC Chairman Jay Clayton has indicated that granting Rule 3-13 relief is a way for the SEC to meet his goal of removing unnecessary barriers to capital formation and making the U.S. public markets more attractive

“I want to encourage companies to consider whether [Rule 3-13 relief] may be helpful in connection with their capital raising activities and assure you that SEC staff is placing a high priority on responding with timely guidance.”

— SEC Chairman Jay Clayton

# Regulatory Reform for the Capital Markets: Confidential Review Expanded

- Scope (regardless of filer category or status):
  - ✓ All initial public offering (IPO) registration statements and other Securities Act registration statements filed before an IPO
  - ✓ All registration statements within one year as a new SEC reporting company
  - ✓ All initial registration statements under Section 12(b) of the Exchange Act
- Registrant may omit interim and annual financial information from the draft registration statement if it reasonably believes it will not be required to present this financial information separately when the registration statement is publicly filed
  - ✓ Different from rule for EGCs, which is based upon expected effective date
  - ✓ Public filing must be at least 15 days before roadshow (or if none, effective date)
  - ✓ Registration statements submitted otherwise should be substantially complete

“This is an important step in our efforts to foster capital formation, provide investment opportunities, and protect investors.”

— Director of the Division of Corporation Finance Bill Hinman

# Regulatory Reform: SEC Disclosure Simplification Release

- **Background.** On August 17, 2018, the SEC adopted several dozen amendments to existing disclosure requirements “to simplify compliance without significantly altering the total mix of information.”
  - ✓ Final rules are largely consistent with the changes proposed in 2016
- **Effective Date.** November 5, 2018
- **Application.** The amendments are effective for all filings made 30 days after publication in the Federal Register.
- **Exception.** The rules require companies to present changes in shareholders equity in their Forms 10-Q. In light of this requirement being imposed right at the time of 10-Q filings, in Exchange Act Compliance & Disclosure Interpretation 105.09, the Staff stated it would not object if companies’ first presentation of the changes in shareholders’ equity is included in its Form 10-Q for the quarter that begins after the effective date of the amendments. For example, a December 31 fiscal year-end filer could omit this disclosure from its September 30, 2018 Form 10-Q.

# Regulatory Reform: Disclosure Simplification (Cont'd)

- Notable changes:
  - ✓ **Amount Spent on R&D.** Disclosure of amounts spent on R&D activities for all years presented (Item 101(c)(1)(xi) of Reg S-K) is no longer required in the “Business” section because U.S. GAAP requires a similar disclosure in the financial footnotes.
  - ✓ **Segment and Geographical Area Information.** Disclosure of financial information about segments (Item 101(b) of Reg S-K) and financial information by geographical area (Item 101(d)(2) of Reg S-K) for the last three years is no longer required in the “Business” section because U.S. GAAP requires a similar disclosure in the notes to the financial statements.
  - ✓ **Foreign Operations.** Disclosure of risks associated with a company’s foreign operations and any segment’s dependence on foreign operations no longer required in the “Business” section as such disclosure can be included in Risk Factors and, if appropriate, in MD&A. To make this point clear, the SEC has added a specific reference to “geographic areas” to the MD&A requirement (Item 303(a) of Reg S-K).

# Regulatory Reform: Disclosure Simplification (Cont'd)

- **Available Information.** Identification of the SEC's Public Reference Room and disclosure of its physical address and phone number (Item 101(e)(2)) are no longer required given the widespread availability on the Internet.
  - ✓ Retained Requirement. However, please note that companies are still required to disclose the SEC's internet address and a statement that electronic SEC filings are available there. Also, the SEC has added a requirement that companies disclose their internet addresses, if they have one. Such disclosure is only encouraged under the current rule (Items 101(e)(3)).
- **Market Price.** Disclosure of historical high and low trading prices of companies' common stock in the last two years (Item, 201(a)(1) of Reg S-K) is no longer required given how easily accessible this information is free of charge.
  - ✓ Retained Requirement. However, please note that companies are still required to disclose trading symbols used for each class of common stock and the principal foreign public trading market in the case of foreign issuers. Also, the requirement for disclosure of historical trading prices is retained for companies with no class of common stock traded on an established trading market.

# Regulatory Reform: Disclosure Simplification (Cont'd)

- **Dividends.** Disclosure of the frequency and amount of cash dividends declared and restrictions that currently are or are likely to materially limit companies' ability to pay dividends on their common equity (Item 201(c)(1) of Reg S-K) is no longer required because current Reg S-X requires similar disclosure. The SEC consolidated such disclosure requirements for domestic companies under a single requirement in revised Rule 4-08(e)(3) of Reg S-X. Companies will now be required to provide such disclosure only in the notes to the financial statements.
- **Seasonality.** Disclosure of seasonality in the "MD&A" section (Instruction 5 to Item 303(b) of Reg S-K) is no longer required because U.S. GAAP requires similar disclosure in the notes to the financial statements and the remainder of the MD&A requirements elicit disclosure of forward-looking information in interim reports to the extent that the effects of seasonality may become material.
  - ✓ Retained Requirement. However, please note that the requirement to disclose seasonality in the "Business" section in the annual report (Item 101(c)(1)(v)) is retained without amendment, in response to comments about the potential loss of information in the fourth quarter about the extent to which a company's business is seasonal because GAAP may not elicit this disclosure.

# Regulatory Reform: Disclosure Simplification (Cont'd)

- **Ratio of Earnings to Fixed Charges.** Disclosure of a ratio of earnings to fixed charges (Item 503(d) of Reg S-K) is no longer required because US GAAP requires disclosure of the components commonly used to calculate these ratios and a variety of other analytical tools are available to investors to achieve a similar objective as the ratio of earnings to fixed charges. Also, companies are no longer required to include this information in an exhibit to their annual report (Item 601(d)(12) of Reg S-K).
- **Earnings per Share.** Disclosure of earnings per share on the face of an interim income statement (Rule 10-01(b)(2) of Reg S-X) is no longer required because US GAAP requires similar disclosure in the notes to the financial statements. Also, companies are no longer required to include a statement showing a calculation of earnings per share in an exhibit to their annual report (previously, companies were required to include such exhibit unless the computation could be clearly determined from the material contained in the annual report) (Item 601(d)(11) of Reg S-K).
- **Pro Forma Business Combination Information.** Requirement of disclosure of supplemental pro forma information about a material business combination in interim filings under Rule 10-01(b)(4) of Reg S-X is eliminated as US GAAP and Item 9.01 of Form 8-K cover similar disclosure requirements.



# Regulatory Reform: Other Changes

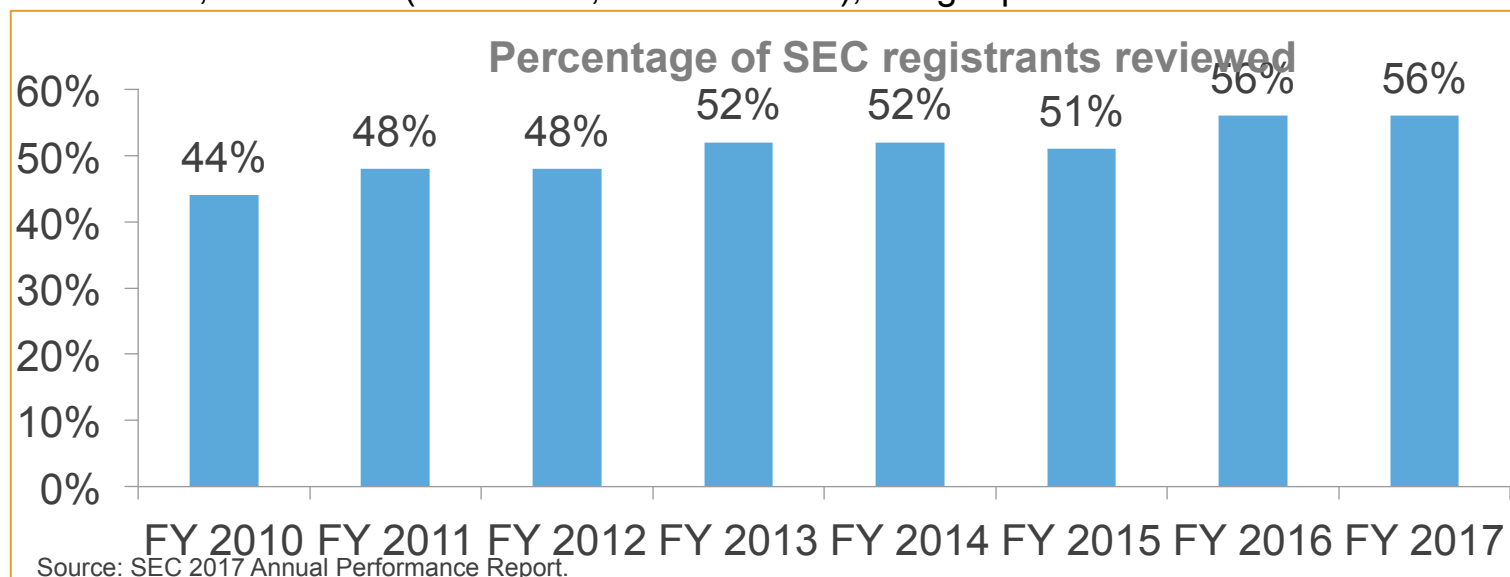
- Rule 701 is an exemption used by non-reporting companies to issue equity incentive awards without registering the offering
  - ✓ July 18, 2018: SEC amended Rule 701 of the Securities Act to increase threshold from \$5 to \$10 million
  - ✓ Provides more flexibility to offer equity to employees without disclosing information that may impact company's competitive advantage
- SEC reduces filing fees for 2019
  - ✓ \$121.20 per million dollars of aggregate offering amount (from \$124.50 in 2018)
  - ✓ Effective October 1, 2018
- Transaction Fee Pilot Program
  - ✓ Generate data to provide public and SEC with information about transaction fees in market transactions
- Investor Advisory Committee kicks off September 2018
  - ✓ Open to the public – Discuss proxy voting infrastructure, passive investing, and other matters

# 2018 Proxy Season Developments: Pay Ratio

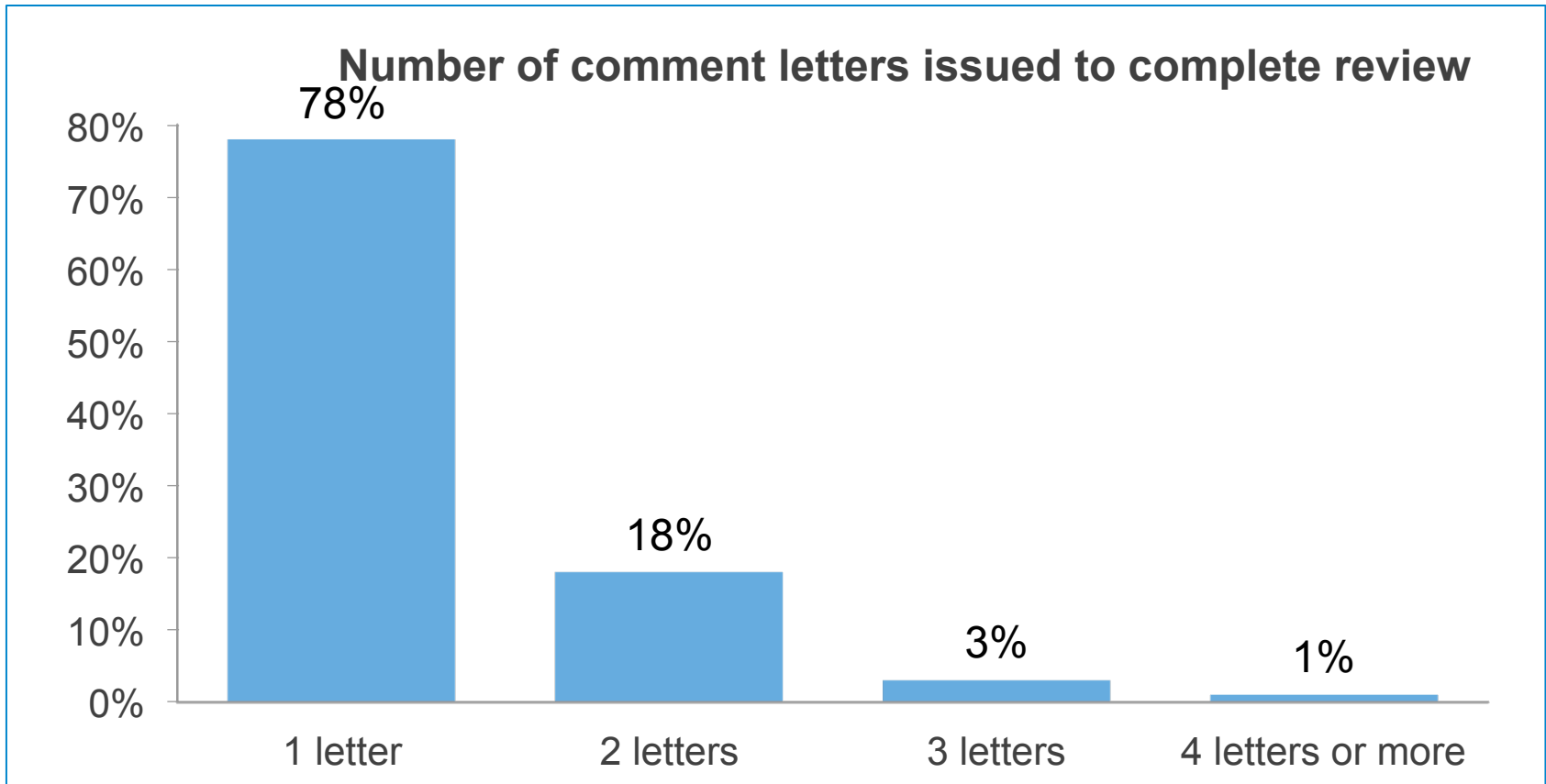
- **Pay Ratio Rules.** The SEC adopted final pay ratio disclosure rules in August 2015. The rules require companies to disclose the annual total compensation of the company's median employee, the annual total compensation of the CEO, and the ratio of the two for fiscal years commencing on or after January 1, 2017.
  - ✓ **S&P 500 Pay Ratio Update.** As of June 29, 2018, a total of 401 S&P 500 companies had filed required pay ratio disclosures. Average pay ratio was 272:1; average median employee compensation was \$79,000 (rounded to the nearest \$1,000). To compare, among Fortune 100 companies, average pay ratio was 310:1, and average employee compensation was \$78,000.
    - ❖ Industry Average. Industries with the highest average ratios were Retail Trade (759:1; average median compensation of \$21,000) and Manufacturing (303:1; average median compensation of \$77,000). The average ratio for companies in the Services Industry was 258:1, with average median compensation of \$87,000.
  - ✓ **State and Local Legislative Initiatives.** In February 2018, California became the ninth jurisdiction to propose pay ratio-related legislation, which would generally increase any required jurisdictional taxes owed by corporations based on their pay ratios (with higher ratios incurring additional tax). Only one jurisdiction (Portland, Oregon) has adopted such legislation; the other eight jurisdictions have proposed pay ratio-related legislation.

# SEC Reviews/Comments

- Reviews by the Division of Corporation Finance
  - ✓ Periodic reports, at a minimum every three years
    - ❖ Mandated by the Sarbanes-Oxley Act
    - ❖ Many registrants reviewed more frequently
  - ✓ IPOs, Forms 8-K (Items 2.02, 4.01 and 4.02), merger proxies



## SEC Reviews/Comments (Cont'd)



# SEC Comment Focus Area: Non-GAAP Measures

- Non-GAAP financial measures may provide an alternative source of information to help investors better understand operating performance, cash flow or financial position
  - ✓ E.g., EBITDA, adjusted EBITDA, funds from operations (FFO), adjusted FFO, adjusted net income, free cash flow
- SEC adopted rules (i.e., Regulation G, Item 10(e) of Regulation S-K) in 2003 governing the use of non-GAAP financial measures
- Although the Staff has said progress has been made, SEC has raised concerns on the growing use and prominence of non-GAAP financial measures
  - ✓ Frequent area of focus in its reviews of public filings and related comment letters
- Revisit practices and disclosure every quarter using robust Staff guidance publicly available

# SEC Comment Focus Area: Management's Discussion and Analysis

- Results of operations
  - ✓ Disclose what and why significant changes occurred
    - ❖ Identify and quantify specific business drivers of results
  - ✓ Discuss key metrics clearly and completely
- Critical accounting estimates
  - ✓ Provide more analysis of how changes in assumptions could affect financial statements

## Known trends and uncertainties

### Type of exposure:

### Describe effect of:

Foreign exchange fluctuations

Foreign currency losses

Economic conditions – low GDP growth

Impairments, revenue reduction

Changes in interest rates

Changes to liquidity and financing costs

Natural disasters (e.g., hurricanes)

Impairments, business disruption losses

# SEC Comment Focus Areas: Segment Reporting

- Identification of chief operating decision-maker (CODM)
  - ✓ Registrants shouldn't default to the CEO as the CODM
  - ✓ CODM does not need to have ultimate decision-making authority
- Identification of operating segments
  - ✓ Neither organizational structure nor reports provided to CODM are determinative
  - ✓ Emphasis should be on how the business is managed
- Aggregation of operating segments into reporting segments
  - ✓ Consider similar economic characteristics and all qualitative criteria
    - ❖ Similarity viewed from the perspective of a reasonable investor
    - ❖ No bright lines on similar economic characteristics; future doesn't overcome past
- Providing appropriate disclosures
  - ✓ Non-GAAP measures – reconcile on segment basis; aggregating segments' gross margin is non-GAAP measure
  - ✓ MD&A at segment level

# SEC Comment Focus Areas

- Staff Accounting Bulletin (SAB) Topic 11.M (SAB 74) disclosures on new standards
  - ✓ Disclose expected quantitative effect on the financial statements
  - ✓ If quantitative effects are unknown, disclose:
    - ❖ When the assessment is expected to be completed and status of project
    - ❖ Qualitative information to help the reader assess the potential significance of the effect on the registrant's financial statements
  - ✓ Disclosures should evolve as the effective date of a new standard nears



# SEC Comment Focus Areas

- SEC staff is monitoring implementation of the new revenue standard
  - ✓ Consistent application is an area of focus
    - ❖ Staff has said similar facts should result in consistent outcomes
  - ✓ SEC staff expects companies to follow items of general agreement of the Transition Resource Group
  - ✓ SEC staff rescinded its interpretive accounting guidance related to revenue recognition (e.g., SAB Topics 8 and 13) effective upon adoption of the new revenue standard
- Cybersecurity disclosures