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Client Alert | US Public Company Advisory

Reminders for US Public Companies for the 2019 Annual Reporting and Proxy Season

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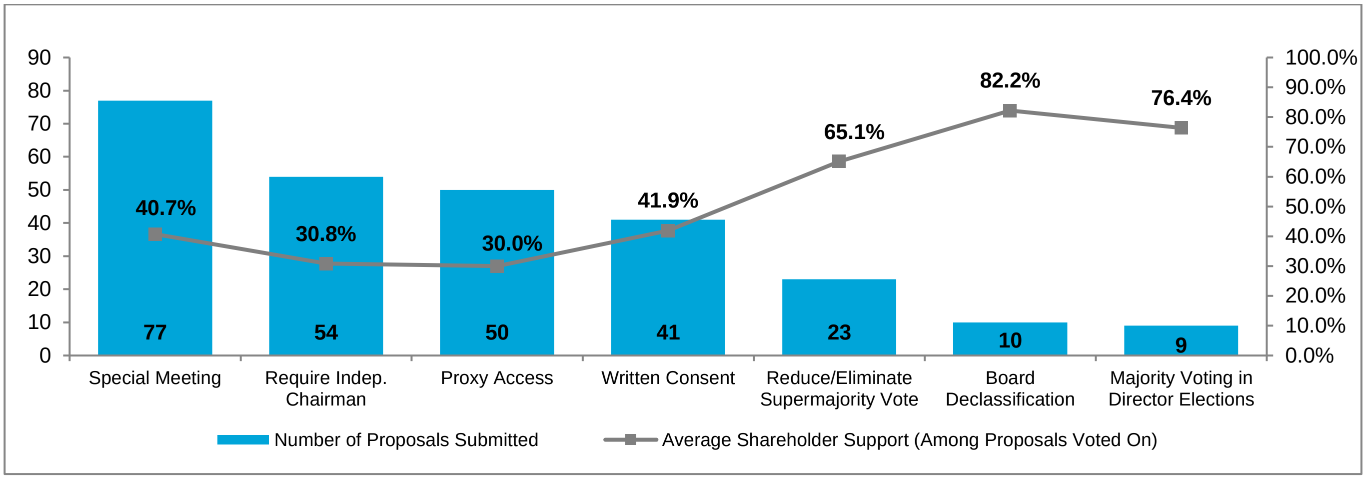
Executive Summary

This memorandum outlines certain considerations for US public companies in preparation for the 2019 annual reporting and proxy season. Part I (pg. 2) provides a summary of certain key trends and insights from the 2018 proxy season, as well as new developments and practical action items for the 2019 proxy season; Part II (pg. 13) sets forth an overview of recent corporate governance developments and trends; Part III (pg. 18) examines disclosure considerations and regulatory updates; and Part IV (pg. 28) includes a brief discussion relating to upcoming regulatory developments and pending rulemaking initiatives.

Part I: Recent Proxy Season Developments

2018 Proxy Season Recap

Corporate Governance Proposals



Special meeting, written consent and proxy access (to adopt proxy access or amend the terms of an existing proxy access right) proposals dominated the landscape in 2018. The overall pass rate for corporate governance proposals declined in the 2018 season, due in large part to a reduction in the relative number of proposals relating to proxy access, majority voting, board declassification and removal of supermajority vote proposals. Proposals requesting an independent board chair, board declassification, majority voting for director elections, and proposals seeking to adopt or amend proxy access were nearly 47% of all governance-related proposals. There was an overall increase in number of proposals seeking positive governance changes, *likely due in part to increased engagement with shareholders*. Boards submitted 160 proposals (up from 117) addressing proxy access, board declassification, majority voting for directors, special meeting, written consent rights, and reduction of supermajority voting requirements; 153 of these proposals received at least 90% support. Independent chair proposals averaged 30.8% support, indicating that shareholders are generally satisfied with a sufficiently empowered lead independent director as an appropriate alternative to a mandatory separation of the CEO and chair roles.

Major Trends:

Special Meeting Proposals

There was a significant increase in proposals relating to the right of shareholders to call a special meeting (77 in 2018 vs. 23 in 2017), overtaking proxy access as the top governance proposal, both in terms of number of proposals submitted and number of proposals voted on (58). The majority of the proposals submitted (57) sought to lower the threshold required to call a special meeting from 25% to 10%; there were also 15 proposals seeking to introduce the right at companies that do not provide for such a right. For S&P 500 companies, 60% currently offer shareholders a right to call special meetings, and of the proposals that went to a vote, only three of the target companies did not provide the right to call a special meeting. Seven of the special meeting proposals passed.

- Institutional investors are generally supportive of giving shareholders the right to call a special meeting, but specific positions vary. Blackrock supports a threshold between 15 – 25 percent. State Street will only support a proposal to lower the threshold if the existing threshold is over 25 percent and the shareholder proposal provides for at least a 10 percent threshold.

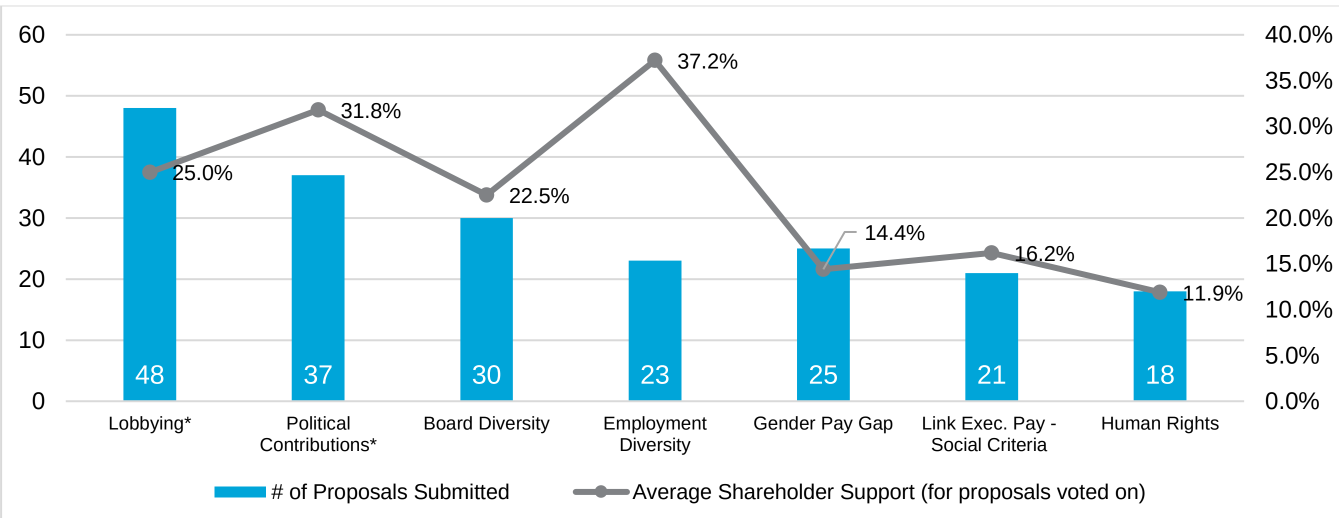
Written Consent Proposals

There was a significant increase in proposals to allow shareholders to act by written consent (41 in 2018 vs. 15 in 2017); however, shareholder support remained low, with only five proposals passing. All of the companies where written consent proposals went to a vote already provided shareholders with the right to call a special meeting. Low passing rates, therefore, seem to reflect agreement by a majority of shareholders that special meeting rights render written consent rights unnecessary. When companies do implement a written consent right, it is often subject to a number of the same terms contained in market standard special meeting provisions.[1]

Proxy Access

More than 500 US companies have adopted proxy access provisions to date, including approximately 87 percent of companies in the S&P 100 and approximately 67 percent of companies in the S&P 500. As a result, there were significantly fewer proposals to adopt proxy access in 2018.[2] Because most companies that received such a proposal (as well as some that did not) chose to adopt proxy access with terms consistent with market practice,[3] fewer proposals to adopt proxy access went to a vote in 2018. In addition, "fix it" proposals seeking to amend existing proxy access terms continued to be unsuccessful. Of the 23 "fix it" proposals that went to a vote in 2018, only four garnered more than 30 percent support, and none of the proposals, which mainly sought to remove or loosen restrictions on group size, passed.

Social Proposals



The number of social proposals submitted during the 2018 proxy season increased slightly relative to 2017. The two largest sub-categories were lobbying/political contributions (85 submitted in 2018) and diversity related proposals (board, employment and gender pay gap) (78 submitted in 2018). However, fewer gender pay equity, equal employment opportunity and board diversity proposals went to a vote (less than half the number in 2017), as many were withdrawn after companies reached agreements with shareholders (particularly with respect to proposals addressing corporate anti-discrimination policies).

Major Trends:

Political Contributions and Lobbying Disclosure

Proposals seeking disclosure related to a company's spending on political contributions and lobbying were the most common type of social proposal in 2018. Although none of these proposals passed, 23 received over 30% support. In addition, 12 proposals were withdrawn, likely due to corporate engagement with the proponents. Many

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1 These include disclosure requirements, holding requirements, and black-outs (*i.e.,* meeting requests not valid if received during a specified period before the annual meeting or after a meeting at which a similar matter was on the agenda).

2 Almost 80% of all shareholder proposals are received by S&P 500 companies.

3 Market practice includes allowing a shareholder, or group of up to 20 shareholders, who have held at least 3 percent of the company's stock for at least 3 years, to nominate up to 20 percent of the board.

S&P 500 companies voluntarily disclose some information related to political spending; in 2018, 294 companies disclosed some or all of their election-related spending, about the same as 2017.[4]

Linking Executive Compensation to Environmental and Social Issues

The most common type of *compensation-related* social proposal sought to link executive compensation to environmental and social issues, such as sustainability, diversity, cybersecurity/data privacy, or risks related to pharmaceutical pricing, with 21 submitted in 2018 (compared to 12 in 2017). These proposals averaged less than 20 percent support, and none passed, but shareholders are increasingly focusing on this issue.

Board Diversity

Although proposals related to board diversity remained relatively stable in 2018, board diversity, especially with respect to women and minorities serving as directors, is an issue that has garnered an increasing amount of attention in the corporate governance arena. Only five proposals went to a vote (three of which were supported by Institutional Shareholder Services ("ISS")), as a significant number were withdrawn, typically after companies reached agreements with the proponents. The proposals that were voted upon averaged a 22.5 percent support rate, and none passed. Campaigns for gender diversity on boards of directors have already had an impact on board composition and recruitment. Equilar reports[5] that for a third consecutive quarter the percentage of women on Russell 3000 boards increased during the second quarter of 2018, with 34.9 percent of new board seats going to women. Spencer Stuart reports[6] that, for the second consecutive year, women and minorities represented half of the class of new S&P 500 directors in 2018. Gender and minority board diversity is likely to remain an important topic for the 2019 proxy season. Investors and regulators continue focusing on this issue, as is evident from the following developments and initiatives:

- *SEC*—In January 2018, the SEC's Office of Minority and Women Inclusion ("OMWI") introduced its "Diversity Assessment Report for Entities Regulated by the SEC,"[7] which is designed to (i) help regulated entities conduct self-assessments of their diversity policies and practices; (ii) provide these entities with a template for submitting information about their self-assessments to OMWI; and (iii) encourage regulated entitled to publish information related to their self-assessments on their websites. Use of the assessment report is voluntary.

- *New York City Comptroller/New York City Pension Funds* – Launched its "Board Accountability Project 2.0" for the 2018 proxy season, sending letters to 151 companies to request disclosure of the skills, race and gender of board members in a standardized board matrix in the proxy statement,[8] as well as seeking engagement to discuss board "refreshment" opportunities to bring new voices and viewpoints onto the board. In a few cases, the Comptroller's office submitted shareholder proposals requesting proxy disclosure of gender and race/ethnicity, as well as skills, experience and attributes, of directors and nominees in a matrix form. The Comptroller's office announced that 80 percent of companies responded to letters, 85 substantively engaged and adopted new processes, 35 now disclose director diversity details, 49 elected new diverse directors and 24 committed to include diverse candidates in every board search.

- *BlackRock* – Publicly stated that it expects to see at least two women directors on every board, indicating that it may vote against nominating/governance committee members if it believes that a company has not accounted for diversity in its board composition.[9]

- *State Street Global Advisors* – Advised that beginning in 2020 it will vote against the entire nominating committee of a company that does not have at least one woman on its board, and has not engaged successfully with State Street for three consecutive years (the existing guidelines target only the chair of the

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4 *See* The 2018 CPA-Zicklin Index of Corporate Political Disclosure and Accountability, available here.

5 Equilar's Q2 2018 Gender Diversity Index can be found here.

6 The 2018 US Spencer Stuart Board Index Highlights is available here.

7 Diversity Assessment Report for Entities Regulated by the SEC. Available here.

8 46 percent of S&P 500 companies provided a board skills matrix in their 2018 proxy statements (up from 27 percent in 2017).

9 See our previous alert, "Blackrock Publishes Updated Proxy Voting Guidelines."

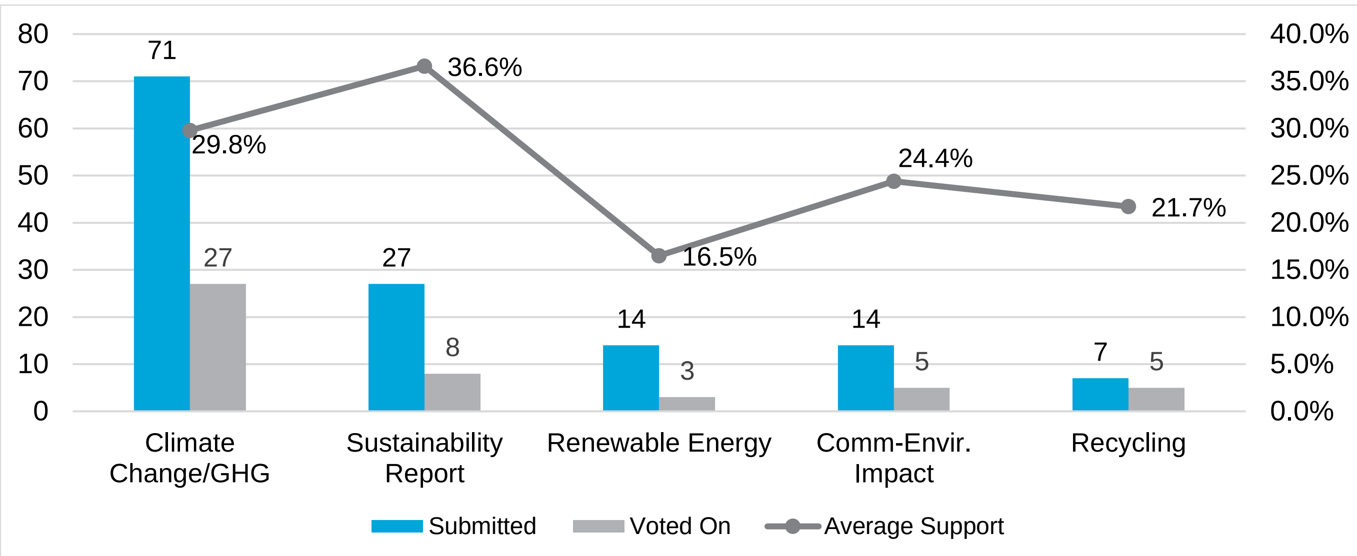
governance committee, rather than all the members). State Street reported that by early March 2018 it had voted against more than 500 companies for failure to demonstrate progress on board diversity.

- *CalPERS* – Engaged with more than 500 US companies in the Russell 3000 index regarding lack of board diversity and adopted a "Board Diversity & Inclusion" voting enhancement to hold directors at these companies accountable for failure to improve diversity on their boards or diversity and inclusion disclosures. CalPERS reported that through May 2018 it withheld votes or voted against 271 directors at 85 companies as a result of board diversity concerns.

- *California S.B.* 826[10] – California recently passed a law that requires publicly traded companies based in California, regardless of state of jurisdiction or incorporation, to have at least one woman on their boards by December 31, 2019. By December 31, 2021, the applicable minimum number will increase to: (i) three female directors, if the company has six or more directors, (ii) two female directors, if the company has five directors, and (iii) one female director, if the company has four or fewer directors.

- *ISS and Glass Lewis* – In 2019, both of these proxy advisory firms updated their voting guidelines with respect to board gender diversity (see below for a discussion of these policies).

Environmental Proposals



Fewer environmental proposals reached a vote this season, as companies were increasingly willing to reach agreements with proponents that led to the withdrawal of many proposals. Seven environmental proposals received majority support in 2018: two asking for preparation of a two-degree scenario (which received 59.7 percent and 53 percent support); one seeking a report on coal ash risk (53.2 percent support); one seeking a report on methane emissions management (50.3 percent support); one asking for a sustainability report (60.4 percent and 57.2 percent support); and one asking a company to set GHG emissions reduction goals (57.2 percent support).

Major Trend:

Climate Change

Climate change proposals were the most prevalent type of environmental proposal, with continued high levels of shareholder support. Out of the 68 environmental proposals that went to a vote, one-third (23) were climate change proposals. Climate change proposals averaged 32 percent support in 2018, similar to the 34.5 percent

10 The full text of the bill is available here.

support in 2017; more than half (12) received greater than 30 percent support, including eight proposals that received more than 40 percent support, with four proposals passing.

While several factors contributed to the increased support for environmental proposals, support from large institutional investors and public pension funds was instrumental in the passing of the four climate change proposals.

Institutional investors are looking at whether a company has integrated environmental risks and opportunities into its strategic planning, and many view sustainability as having a material impact on long-term corporate performance. Notwithstanding the applicable disclosure requirements, a company's environmental, social and governance ("ESG") disclosure should be tailored to the information the company's large shareholders want to know. This disclosure can be provided in a company's proxy statement, although most of this information will likely be provided in a separate sustainability report or on a company's website. Generally, these reports are positively perceived by investors.

Select ESG Developments

ESG Guidelines Rule-Making Petition

In October 2018, a group of investors, state treasurers, public pension funds, unions, legal experts and ESG advocates representing more than $5 trillion in assets filed a rule-making petition[11] asking the SEC "to promptly initiate rule-making to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful environmental, social and governance information." Petitioners[12] argued that standardized disclosure is critical for evaluating companies' long-term performance and risk management and that disparate reporting methods make it difficult for investors to compare companies or rely on the information for their investment decisions. They emphasized that their position was as fiduciaries looking to maximize returns and evaluate factors that could affect long-term risks, not promote personal values. Although 80 percent of large companies produce some kind of sustainability report, these reports are inconsistent due in part to a lack of guidance from the SEC.

ISS Environmental & Social QualityScore

While there were already several prominent ESG rating groups (for example, MSCI, Sustainalytics and RobecoSam), in 2018, ISS launched its Environmental & Social QualityScore platform[13] ("E&S QualityScore"), a data-driven approach to measure the quality of corporate disclosures on environmental and social issues, including sustainability governance, and to identify key disclosure omissions.[14] E&S QualityScore includes more than 380 environmental and social factors under analysis and provides a top-level score for both environmental and social, as well as scores for each category underneath each topic, on a scale of 1 (higher quality disclosure) to 10 (lower quality disclosure) relative to peer companies in their specific industry group. In November, ISS announced the addition of a new "Board Diversity" subcategory, which takes into account existing factors as well as factors such as: (i) the number of women serving in key leadership roles on the board, (ii) the number of female named executive officers, (iii) the standard deviation of director age, and (iv) the standard deviation of director tenure. The E&S QualityScore will have no impact on ISS' proxy voting recommendations.

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[11] The petition is available here.

[12] Including the US$360 billion CalPERS; the New York state Comptroller; the Illinois state Treasurer; the Connecticut state Treasurer; the Oregon state Treasurer; the U.N. Principles for Responsible Investment; and US SIF: The Forum for Sustainable and Responsible Investment.

[13] Available here.

[14] As part of its announcement, ISS also provided FAQs and a companion Key Issues document.

ISS[15] [16] and Glass Lewis[17] [18] Proxy Voting Guidelines

Board Gender Diversity

For 2019, ISS will highlight boards with no gender diversity; however, it will not make adverse vote recommendations due to a lack of gender diversity. Effective for meetings taking place on or after February 1, 2020, ISS will generally vote against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis) at companies in the Russell 3000 or S&P 1500 indices where there are no women on the company's board. Mitigating factors include: (i) a firm commitment, as stated in the proxy statement, to appoint at least one female director in the near term; (ii) the presence of a female on the board at the preceding annual meeting; or (iii) other relevant factors as applicable.

For 2019, Glass Lewis will generally recommend voting against the chair of the nominating committee of a board that has no female members. Glass Lewis may also recommend voting against the other members of the nominating committee, depending on other factors, including: (i) the size of the company, (ii) the industry in which the company operates, and (iii) the governance profile of the company. When making its voting recommendations, Glass Lewis will carefully review a company's disclosure of its diversity considerations (including whether boards have provided a sufficient rationale for not having any female board members or have disclosed a plan to address the lack of diversity on the board), and may not recommend that shareholders vote against directors of companies outside the Russell 3000 index.

Board Accountability and Shareholder Rights & Defenses – Management Proposals to Ratify Existing Charter or Bylaw Provisions

ISS has added a new policy for 2019 pursuant to which it will vote against/withhold from individual directors, members of the governance committee, or the full board, where boards ask shareholders to ratify existing charter or bylaw provisions considering the following factors: (i) the presence of a shareholder proposal addressing the same issue on the same ballot; (ii) the board's rationale for seeking ratification; (iii) disclosure of actions to be taken by the board should the ratification proposal fail; (iv) disclosure of shareholder engagement regarding the board's ratification request; (v) the level of impairment to shareholders' rights caused by the existing provision; (vi) the history of management and shareholder proposals on the provision at the company's past meetings; (vii) whether the current provision was adopted in response to the shareholder proposal; (viii) the company's ownership structure; and (ix) previous use of ratification proposals to exclude shareholder proposals.[19] ISS will generally also vote against management proposals to ratify provisions of the company's existing charter or bylaws, unless these governance provisions align with best practice.

ISS has also updated its responsiveness policy to provide that if the board failed to act on a management proposal to ratify existing charter/bylaw provisions that was opposed by a majority of votes cast, this will trigger a board responsiveness analysis at the following annual meeting.

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15 ISS' 2019 Voting Guidelines can be found here.

16 In addition to the below, ISS also updated its policies on director performance evaluations, reverse stock splits and environmental and social shareholder ("E&S") proposals (adding whether there are significant controversies, fines, penalties or litigation associated with the company's E&S practices as a factor it will consider).

17 Glass Lewis' 2019 Policy Guidelines can be found here.

18 In addition to the below, Glass Lewis also added clarifying language regarding its approach to the following topics: (i) peer groups, (ii) pay-for-performance, (iii) use of discretion, (iv) director compensation, and (v) bonus plans.

19 This is in response to an increase in the use of board-sponsored proposals to ratify existing charter or bylaw provisions in response to guidance from SEC staff that granted some companies' requests to grant no-action relief if companies sought to exclude shareholder proposals from their ballots by including a "conflicting" management-sponsored proposal to ratify one or more of their existing governance provision citing 14a-8(i)(9). See below discussion under "Shareholder Proposal and No-Action Letter Developments – SEC's Corp Fin Further Refines Rule 14a-8(i)(9) Exclusion."

Conflicting and Excluded Special Meeting Proposals

Glass Lewis has codified its policy regarding conflicting special meeting shareholder resolutions:

- Where there is both a management proposal and a shareholder proposal requesting different thresholds for the right to call a special meeting, Glass Lewis will generally recommend voting for the lower threshold and against the higher threshold.

- Where there are conflicting management and shareholder special meeting proposals and the company does not currently maintain a special meeting right, Glass Lewis may consider recommending that shareholders vote in favor of the shareholder proposal and abstain from voting on management's proposal.

- Where companies have excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right, Glass Lewis will typically recommend against the ratification proposal, as well as members of the nominating and governance committee.

In addition, Glass Lewis will make note of instances where the SEC has allowed companies to exclude shareholder proposals, which may result in recommendations against members of the governance committee in very limited circumstances if Glass Lewis believes the exclusion was detrimental to shareholders.

Diversity Reporting

Glass Lewis will generally recommend in favor of shareholder proposals requesting additional disclosure on: (i) employee diversity, and (ii) the steps companies are taking to promote workforce diversity.

Environmental and Social Risk Oversight

Glass Lewis has codified its approach to reviewing how boards oversee environmental and social issues:

- For large cap companies and where material oversight issues are identified, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of environmental issues and/or social issues.

- Glass Lewis will also note instances where oversight of environmental and/or social issues has not been clearly defined by companies in their governance documents.

- Where it is clear that companies have not properly managed or mitigated environmental or social risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, Glass Lewis may consider recommending that shareholders vote against members of the board who are responsible for oversight of environmental and social risks.

- In the absence of explicit board oversight of environmental and social issues, Glass Lewis may recommend that shareholders vote against members of the audit committee.

Ratification of Auditor

Glass Lewis codified that when reviewing auditor ratification proposals, additional factors it will consider include: (i) auditor's tenure, (ii) a pattern of inaccurate audits, and (iii) any ongoing litigation or significant controversies that call into questions an auditor's effectiveness. In limited cases, these factors may contribute to a recommendation against auditor ratification.

Virtual Shareholder Meetings

For companies that opt to hold virtual-only annual shareholder meetings (without the option of in-person attendance), Glass Lewis may recommend voting against members of the governance committee if the company does not provide disclosure assuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

Written Consent Shareholder Proposals

Glass Lewis adjusted its approach to written consent shareholder proposals such that, in instances where companies have adopted proxy access and a special meeting right with a threshold of 15 percent or lower, Glass Lewis will generally recommend against shareholder proposals requesting that companies adopt a shareholder right to act by written consent.

Board Composition – Attendance

ISS has codified its approach that in cases of chronic poor meeting attendance by a director, without reasonable justification, in addition to voting against the director, ISS will generally vote against or withhold from appropriate members of the nominating/governance committees or the full board.[20]

Excise Tax Gross-Ups

Glass Lewis will now consider recommending against members of a company's compensation committee if new excise tax gross-ups are provided in executive employment agreements, particularly in situations where a company previously committed not to provide any such entitlements in the future.

Shareholder Activism Trends and Developments

Exempt Solicitations

Under Exchange Act Rule 14a-6(g), any person who owns more than $5 million of a company's securities and who solicits shareholders on a topic, but does not seek proxy voting authority, must file with the SEC a Notice of Exempt Solicitation, which appears on the company's EDGAR page as Form PX14A6G. In July 2018, the SEC clarified in a new Compliance and Disclosure Interpretation ("C&DI")[21] that shareholders owning *less* than $5 million of a company's securities are permitted to file a notice of exempt solicitation on a voluntary basis as long as the cover of the notice clearly identifies it as a voluntary filing.

There has been a significant increase in the number of exempt solicitation filings made by both institutional investors (sometimes in response to a company's statement in opposition to a shareholder proposal or to encourage shareholders to vote a specific way) and retail investors who do not meet the $5 million holding threshold, with filings for 2018 up 43 percent compared to 2016. So far, these solicitations have not had any meaningful impact on votes. However, given SEC guidance, companies should be prepared to monitor and respond to a proliferation of Form PX14A6G filings during the 2019, including informing the SEC if they believe an exempt solicitation filing contains materially false or misleading information, or is clearly not filed by a shareholder of the company, in order to potentially contest the filing.

"Vote No" Campaigns

While the numbers have remained relatively stable (18 in 2018, 18 in 2017, 22 in 2016 and 15 in 2015), there has been a recent increase in the visibility of "vote no" or "withhold" campaigns in which activists campaign against one or more directors supported by the board without proposing a slate of their own. Some shareholders use "vote no" campaigns to signify their discontent with the board of directors, in some cases targeting individual directors as a proxy for specific issues. "Vote no" campaigns are also used to pressure boards to reform themselves and drive change without the expense of formal proxy contest; to respond to a rejected takeover offer, when shareholders have missed the deadline for nominating their own slate; to express shareholder sentiment on economic or strategy-related issues; or to express dissatisfaction with company performance. These campaigns

[20] Currently, the policy is generally applied as follows: (a) After three years of poor attendance by a director, recommend withhold from the chair of the nominating or governance committee; (b) After four years, recommend withhold from the full nominating or governance committee; and (c) After five years, recommend withhold from all nominees.

[21] Available here.

can have a significant impact on the targeted director and the board as a whole. Even a director who technically survives the vote may resign or be removed afterwards if the result is too damaging, and in companies with a resignation policy, if a director fails to receive the requisite vote, the board must decide whether to accept such director's resignation or face criticism from shareholders, ISS and Glass Lewis if it decides not to accept.

Shareholder Proposal and No-Action Letter Developments

Exclusion of Shareholder Proposals under the Ordinary Business Exception of Rule 14a-8(i)(7) and the Economic Relevance Exception of Rule 14a-8(i)(5)

In 2017, the staff (the "Staff") of the SEC's Division of Corporation Finance ("Corp Fin") issued guidance[22] and subsequent statements,[23] which indicated that companies submitting no-action letter requests based on the "economic relevance"[24] and "ordinary business" exceptions[25] *could* include a discussion of the board's analysis of the particular policy issue raised by the proposal and its significance in relation to the company, since no-action requests made on these bases often raise difficult judgment calls that the Staff believes are matters that the board is generally best suited to analyze. During the 2018 proxy season, a number of companies included board analyses as part of their no-action requests; however, only one such request was granted.[26] To clarify what type of information is most helpful in a board analysis in connection with a no-action request, in October 2018, the Staff issued Staff Legal Bulletin 14J ("SLB 14J").[27] SLB 14J also provides the Staff's views on the scope and application of (i) "micromanagement" as a basis to exclude a proposal under the "ordinary business" exception; and (ii) the "ordinary business" exception for proposals concerning executive and/or director compensation matters.

Board Analysis

SLB 14J encourages companies that are including a board analysis to describe the specific substantive factors considered by the board, rather than focusing on the process undertaken by the board.[28] While the absence of a board analysis will not create a presumption against exclusion, it may be difficult for the Staff to exclude a

[22] Staff Legal Bulletin 14I. See our prior alert, "SEC Releases Timely Guidance on Shareholder Proposals."

[23] See statements by Corp Fin Director William Hinman and Corp Fin Associate Director Michele Anderson at the November 2017 PLI Securities Regulation Institute, and Corp Fin Senior Special Counsel Matt McNair on a webcast presented by thecorporatecounsel.net, available here.

[24] Rule 14a-8(i)(5) permits a company to exclude a proposal that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business."

[25] Rule 14a-8(i)(7) permits a company to exclude a proposal that "deals with a matter relating to the company's ordinary business operations."

[26] Dunkin' Brands Group, Inc. (avail. Feb. 22, 2018).

[27] See our prior alert "SEC Releases New Guidance on Board Analyses and Rule 14a-8 Ordinary Business and Economic Relevance Exceptions."

[28] These include, among other things,: (i) the extent to which the proposal relates to the company's core business activities, (ii) quantitative data, including financial statement impact, illustrating whether or not the matter is significant to the company, (iii) whether the company has already addressed the issue in some manner, including the differences between the proposal's specific request and the actions the company has already taken, and an analysis of whether such differences present a significant policy issue for the company, (iv) the extent of shareholder engagement on the issue and the level of interest shareholders have expressed on the issue; (v) whether there have been other requests for the action or information sought by the proposal; and (vi) whether the company's shareholders have previously voted on the matter and, if so, how the board views those voting results.

Previous voting results were a key issue for several no-action letters submitted during the 2018 proxy season. SLB 14J makes clear that if a previously voted-on matter received "significant shareholder support," the Staff will consider whether the company has taken any subsequent action or whether other intervening events have occurred since the vote that may have mitigated or increased the issue's significance to the company. In addition, the more recent a vote, the more likely it is to indicate significance.

proposal without such an analysis when the significance of the issue in question may depend on factors that the board is well positioned to evaluate.[29]

Ordinary Business Micromanagement

SLB 14J explains that under the ordinary business exception a proposal with a proper subject matter may still be excludable if it "probe[s] too deeply into matters of a complex nature," involves intricate detail, or asks for specific time frames or methods for implementing complex policies.[30]

Proposals that Address Senior Executive or Director Compensation

Proposals that relate to the management of the workforce and general employee compensation and benefits are generally excludable as ordinary business matters, while those focused on senior executive and/or director compensation generally are not excludable as they are viewed as significant policy matters. SLB 14J clarified that the Staff will examine whether the underlying concern of the proposal is truly focused on aspects of senior executive or director compensation or merely touches upon or implicates senior executive or director compensation. Further, if the proposal focuses on elements of compensation generally available to the workforce, then it is likely excludable under the ordinary business exception. Finally, although historically, the Staff has not excluded executive and/or director compensation proposals on the basis of micromanagement, the Staff now agrees that such proposals can be excluded on this basis if they seek intricate detail, or seek to impose specific timeframes or methods for implementing complex policies.[31]

Key Considerations

Because shareholder proposals generally must be addressed during an extremely busy time of the year for most companies, careful consideration should be given as to whether providing a board analysis is a worthwhile investment of the board's time. Evaluation by the board[32] may be warranted if the issue in question depends on factors that the company believes are not self-evident and that can be best analyzed and explained by the board. If it is determined that an analysis by the board is appropriate, efforts should be made to streamline the process, provide the board with the requisite information for its analysis and schedule meetings as necessary to finalize the analysis in advance of the deadline for submitting a no-action request.

SEC's Corp Fin Further Refines Rule 14a-8(i)(9) Exclusion

Rule 14a-8(i)(9) allows a company to exclude a shareholder proposal that "directly conflicts" with a management proposal. In 2015, the Staff narrowed the application of Rule 14a-8(i)(9) by redefining the meaning of "direct

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29 While a board analysis is not required, the SEC recently denied no-action relief to a company that did not include a board analysis in its request to exclude a shareholder proposal under the ordinary business exception. The Staff specifically noted that "the information presented includes neither a board analysis nor other analysis addressing the significance of the particular proposal to the Company's business operations" and cited SLB 14J's emphasis on the importance of including such an analysis where "the significance of a particular issue…may depend on factors that are not self-evident and that the board may be well-positioned to consider and evaluate." *See* Walgreens Boots Alliance, Inc. (avail. Nov. 20, 2018).

30 For example, a proposal seeking a plan to reach net-zero greenhouse gas emissions by 2030 which imposed specific time frames or methods was excludable because it was determined to be micromanaging the company. *See* Apple Inc. (December 5, 2016). Recently, the Staff allowed exclusion of a proposal requesting that shareholder approval be required prior to effectiveness of any new open market share repurchase programs or stock buybacks adopted by the board under the micromanagement exception, as "the [p]roposal would make each new share repurchase program and each and every stock buyback dependent on shareholder approval." *See* Walgreens Boots Alliance, Inc. (avail. Nov, 20, 2018).

31 For example, a proposal detailing the eligible expenses covered under a company's relocation expense policy such as the type and duration of temporary living assistance, as well as the scope of eligible participants and amounts covered, may be excludable on the basis of micromanagement.

32 It is also appropriate/acceptable for the requisite analysis to be performed by a committee of the board.

conflict"[33] and further refined its position[34] in a series of no-action responses in 2018[35] which allowed companies to exclude shareholder proposals that "directly conflicted" with management proposals where a management proposal asked shareholders to ratify an existing corporate governance provision (in these cases, special meeting thresholds) and the shareholder proposal asked for a lower threshold.[36] However, in each of those cases, the provisions that the companies were submitting to the shareholders for ratification already existed in the companies' governing documents. By contrast, the Staff did not concur that a company could exclude a proposal asking the company's board to take the steps necessary to amend the bylaws to give shareholders the right to call a special meeting, where the company's "counterproposal" was to amend existing bylaws and charter provisions under which only the board or CEO could call a special meeting.[37] Noting that shareholders were not currently permitted to call a special meeting and that the bylaw amendments would only become effective upon shareholder approval, the Staff found that both proposals sought to give shareholders the ability to call a special meeting "[and did] not present shareholders with conflicting decisions such that a reasonable shareholder could not logically vote in favor of both proposals."[38] Companies considering no-action requests based on a "direct conflict" between a management and shareholder proposal should evaluate whether the proposals "directly conflict" given the nuanced position taken by the Staff in the previous requests.

33 *See* Staff Legal Bulletin 14H ("SLB 14H"), available here, under which the key question in evaluating a possible Rule 14a-8(i)(9) exclusion for "conflicting proposals" is "whether a reasonable shareholder could logically vote for both proposals" because both seek a similar objective. If so, the proposals were not in "direct conflict."

34 Post-SLB 14H, the Staff addressed its application in a series of no-action responses, in each case granting no-action relief to the company under Rule 14a-8(i)(9). In all of those cases, the provisions that the companies were submitting to the shareholders for ratification already existed in the companies' governing documents. As a result, the companies were seeking only shareholder ratification; no further shareholder action was necessary to implement the charter and bylaw provisions, and in each case the Staff allowed the exclusion of the shareholder proposal seeking changes to the thresholds provided in such provisions.

35 *See* Illumina, Inc. (avail. March 18, 2016), AES Corporation (avail. December 19, 2017), CF Industries Holdings (avail. January 30, 2018) and Capital One (avail. Feb 21, 2018).

36 In one subsequent similar no-action response, the Staff conditioned no-action relief on the company making specified disclosures in its proxy statement. Specifically, the company had to disclose: (i) the shareholder proposal that the company omitted, (ii) that the company believes a vote in favor of ratification is tantamount to a vote against lowering the relevant threshold, (iii) the impact on the threshold, if any, if ratification is not received, and (iv) the company's expected course of action, if ratification is not received.

37 Neither the amendment to the certificate nor the amendment to the bylaws could become effective until the certificate amendment was approved by the shareholders.

38 American Airlines Group (avail. April 2, 2018).

Part II: Corporate Governance Developments

New Proxy C&DIs

In May 2018, Corp Fin issued 45 new C&DIs to replace the interpretations in the Telephone Interpretation Manual and the March 1999 Supplement that relate to the proxy rules and Schedules 14A and 14C.[39]

Board Oversight of Risk Exposure

Oversight of Social Media Risk; Disclosure Controls Impact

The SEC's recent action against Tesla and its CEO[40] highlights the importance of having disclosure controls for *all* corporate communications and makes clear that the SEC is focused on communications from a company in any form. Accordingly, all communications made on behalf of a company must be vetted as carefully as traditional modes of communication, such as SEC filings, and companies should have formal disclosure controls and procedures in place around all corporate communications as well as a written disclosure policy that specifically

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39 The six substantive changes were:

(1) If action is to be taken with respect to the election of directors and the persons solicited have cumulative voting rights, a soliciting party can cumulate votes among director nominees, even if a choice has not been specified by the security holder, by simply indicating this in bold-faced type on the proxy card, as long as state law grants the proxy holder the authority to exercise discretion to cumulate votes and does not require separate security holder approval for cumulative voting. (Question 124.01)

(2) A registrant must file preliminary proxy materials if it receives adequate advance notice of a non-Rule 14a-8 matter that may be raised at a meeting if Rule 14a-4(c)(2) does not permit the company to exercise discretionary authority on such matter. (Question 124.07)

(3) A proposed change in the registrant's name, by itself, does not require the filing of a preliminary proxy statement. (Question 126.02)

(4) If raising proceeds through a sale of common stock is not an integral part of an acquisition transaction because at the time the acquisition consideration is payable, the registrant has other means of fully financing the acquisition, then a proposal to approve the authorization of a common stock issuance would not involve the acquisition and Note A of Schedule 14A would not apply. By contrast, if the cash proceeds from the public offering are expected to be used to pay any material portion of the consideration for the acquisition, then Note A would apply. (Question 151.01)

(5) If a registrant is required to disclose the New Plan Benefits Table under Item 10(a)(2) of Schedule 14A, it should list in the table all of the individuals and groups for which award and benefit information is required, even if the amount to be reported is "0"; alternatively, it can identify any such individuals or groups through narrative disclosure that accompanies the New Plan Benefits Table. (Question 161.03)

(6) A proxy statement seeking security holder approval for the elimination of preemptive rights from a security does involve a modification of that security for purposes of Item 12 of Schedule 14A and accordingly must contain the financial and other information required by Item13 of Schedule 14A. (Question 161.01)

40 Tesla's Elon Musk was charged with securities fraud related to tweets in which he stated that he had secured funding to take Tesla private at a substantial premium to its then-current trading price and that the only remaining uncertainty was a shareholder vote. The SEC's complaint alleged that, in truth, Musk had not discussed specific deal terms with any potential financing partners and knew that the potential transaction was uncertain and subject to numerous contingencies, thereby making untrue statements of material fact in violation of the anti-fraud provisions of Section 10(b) of the Exchange Act of 1934. The SEC also charged Tesla with violating Rule 13a-15 of the Exchange Act for failing to have required disclosure controls and procedures relating to Musk's tweets. Despite having notified the market in 2013 that it intended to use Musk's Twitter account as a means of announcing material information about the company and encouraging investors to review Musk's tweets, Tesla had no disclosure controls or procedures in place to determine whether Musk's tweets contained information required to be disclosed in Tesla's SEC filings, nor did it have sufficient processes in place to ensure that Musk's tweets were accurate or complete. The SEC's complaint against Musk is available here and the complaint against Tesla is available here. Both Musk and Tesla settled with the SEC. Among other relief, the settlements required that: (i) Musk step down as Tesla's Chairman and be replaced by an independent Chairman. Musk will be ineligible to be re-elected Chairman for three years; (ii) Tesla will appoint a total of two new independent directors to its board; (iii) Tesla will establish a new committee of independent directors and put in place additional controls and procedures to oversee Musk's communications; and (iv) Musk and Tesla will each pay a separate $20 million penalty, to be distributed to harmed investors under a court-approved process. The SEC's statement on the settlement is available here.

covers corporate communications via social media channels. All information disclosed through social media channels must be reviewed before publication for accuracy, completeness, and compliance with any regulatory requirements. Special procedures should be put in place around corporate communications made by individual senior executives through their personal accounts to the extent that the company has individual executives communicating material information on its behalf. This is necessary even if the company has previously announced that such medium will be used for company communications (thereby indicating that it should be relied on as a Regulation FD-compliant forum for the company).

Further, companies should ensure that their disclosure policy is regularly updated to reflect the latest technological developments in social media and changes in the use of social media by corporate executives, as well as developments in applicable laws and relevant regulatory guidance. A formal communications/disclosure plan or guidelines should establish a hierarchy for clearing communications on significant corporate issues.

Oversight of Cybersecurity Risk (and Related Disclosure and Governance Considerations)

Board Oversight

Ensuring the adequacy of a company's cybersecurity measures is a critical part of a board's risk oversight responsibilities.[41][42] In February 2018, the SEC issued an interpretive release[43] providing guidance (the "Cybersecurity Guidance") to assist public companies in preparing disclosures about cybersecurity risks and incidents.[44] Among other things, the Cybersecurity Guidance discusses cybersecurity and its related disclosure requirements as a key element of enterprise risk management in which program development and oversight responsibilities move straight "up the corporate ladder" to officers and directors. Oversight of cybersecurity risk may be vested in a committee of the board[45] or the board as a whole, and companies should make this decision carefully, as it can signal the relative importance the company places on cybersecurity issues. Directors must understand the nature of cybersecurity risk and prioritize their oversight of cyber preparedness, detection, response, and disclosure. Boards should receive periodic updates from management and any relevant expert advisors on the company's compliance with applicable standards.[46] Further, board oversight of cyber risk management, including how the board engages with management on cybersecurity issues, should be disclosed to the extent cybersecurity risks are material to the business.

SEC Commissioner Kara Stein also articulated her views about board cybersecurity oversight in a September 2018 speech.[47] Most notably, she: (i) supported the notion of boards retaining independent experts to provide advice on technology and cybersecurity if they lack independent expertise on the board; (ii) advised independent directors to meet with the company's CISO in executive session at least twice a year to facilitate candid dialogue about "culture, tone and the resources dedicated to both prevention and resiliency"; and (iii) emphasized the board's duty to affirm that the company's disclosures adequately reflect its significant cyber risks.

[41] The Center for Audit Quality has issued a "Cybersecurity Risk Management Oversight: A Tool for Board Members", which offers questions that directors can ask of management and the auditors as part of their oversight of cybersecurity risks and disclosures.

[42] 84 percent of Fortune 100 companies disclosed in their proxy statement or 10-K that at least one board-level committee was designated oversight of cybersecurity matters. At the same time, around 25 percent identified one or more "point persons" on cyber among the management team (e.g., the CISO or CIO). *See* EY Center for Board Matters "Cybersecurity Disclosure Benchmarking", available here.

[43] Available here.

[44] See our prior alert, "SEC Issues Interpretive Guidance on Public Company Cybersecurity Disclosures: Greater Engagement Required of Officers and Directors."

[45] In many companies, the Audit Committee retains primary oversight of cybersecurity risks, consistent with its role in oversight of enterprise risks generally. However, in some companies it may make sense to assign primary oversight of cybersecurity to a Risk Committee that oversees a range of the company's enterprise risks or a Technology Committee focused on oversight of technology-related risks.

[46] Boards are increasingly seeking director candidates with cybersecurity knowledge, although qualified candidates can be difficult to find. *See* EY's "Understanding the Cybersecurity Threat," available here.

[47] "From the Data Rush to the Data Wars: A Data Revolution in Financial Markets" (speech given on September 27, 2018).

Disclosure Considerations

The SEC is focused on timely and accurate disclosure, as illustrated by its recent enforcement case against Yahoo[48] in which the company was fined US$35 million for failing to timely disclose a personal data breach that impacted more than 500 million user accounts, demonstrates that a company has an affirmative obligation to disclose a material breach in a timely manner. In addition, Yahoo's failure to consult with outside counsel and auditors may be an indication of a failure in its disclosure controls, underscoring the importance of maintaining robust internal controls around issues of cybersecurity.

The Cybersecurity Guidance encourages companies to consider their obligation to disclose cyber risks and incidents as they relate to risk factors, MD&A, description of business, legal proceedings and financial statement disclosures, along with their disclosures regarding the role of the company's board of directors in the risk oversight of the company. Companies, however, are not expected to disclose specific information about their cybersecurity systems or vulnerabilities that could compromise their cybersecurity efforts and serve as a roadmap for hackers.

The SEC has indicated that it is particularly focused on these disclosures as part of their periodic reviews for the upcoming reporting cycle, and care should be taken to craft disclosure that accurately and thoroughly addresses the company's cybersecurity risks, incidents and protocols. Companies should be aware that when reviewing a company's periodic reports, the SEC will also consider a company's disclosure on its website, in its earnings calls and in press releases; therefore, internal consistency with respect to cybersecurity disclosure is very important and should be regularly assessed.

Given this focus and the Cybersecurity Guidance, companies should review their disclosure to ensure it accurately reflects the company's cybersecurity risk profile, and the potential impact and costs of cybersecurity efforts and initiatives. This is the first year that disclosures will be drafted with this guidance in mind, and companies should pay particular attention to:

- *Risk Factors*: Evaluate how to communicate risks properly in light of the probability and magnitude of past and potential future cybersecurity events; consider disclosure regarding adequacy of preventive actions; discuss material industry, customer and/or supplier-specific risks that may increase the potential impact; discuss material risks related to insurance and other costs; consider disclosure regarding material risks of reputational harm; and consider disclosure regarding compliance with any applicable regulatory requirements.
- *MD&A*: Consider the costs of ongoing cybersecurity efforts and the consequences of cybersecurity incidents when analyzing the events, trends and uncertainties that are reasonably likely to materially impact financial condition or liquidity.
- *Business Description*: Include disclosure of cybersecurity incidents or risks that materially affect products, services, competitive conditions or business relationships, with additional consideration given to any unique cybersecurity risks that may stem from acquisitions.
- *Financial Statements*: Financial statement disclosure should include information about the range and magnitude of cybersecurity events, such as investigation and remediation costs, claims, loss of revenue, diminished future cash flow, impairment of assets, and increased financing costs.

Governance Considerations

The Cybersecurity Guidance also provides the following guidance with respect to governance policies around cybersecurity issues:

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48 Yahoo's risk factor disclosures in its annual and quarterly reports were materially misleading in that they claimed the company only faced the "risk of potential future data breaches" that might expose the company to loss and liability "without disclosing that a massive data breach had in fact already occurred." The SEC's action is available here. For more information, see our prior alert, "SEC Fines Yahoo $35 Million for Failure to Timely Disclose a Cyber Breach."

- *Disclosure Controls and Procedures*

Companies are encouraged to adopt comprehensive policies and procedures related to cybersecurity. A company's conclusions with respect to the effectiveness of disclosure controls and procedures must be informed by management's consideration of cybersecurity risks and incidents, taking into account the degree to which cybersecurity risks impact the effectiveness of those controls and procedures.

The SEC is also focused on ensuring that a company's cybersecurity policies and governance procedures are not merely formalized in writing, but that they work in practice. For example, in September 2018, the SEC initiated an enforcement action[49] against Voya Financial Advisors for violating the "Identity Theft Red Flags Rule,"[50] alleging that although Voya had an identity theft prevention program in place, it did not update it to account for changing cybersecurity risks to its customers, did not include procedures to identify the red flags that led to the intrusion, did not provide training to its employees, and neither the board nor a management team was involved in administering and overseeing the program, and these failures allowed hackers to access social security numbers, account balances and details of client investment accounts. Companies should ensure that their procedures are regularly updated to address changing risks and that existing policies and procedures are implemented effectively, including through appropriate employee training.

- *Insider Trading*

Companies and their directors, officers, and other corporate insiders are reminded that information about cybersecurity risks and incidents, including vulnerabilities and breaches, may constitute material non-public information ("MNPI") for purposes of insider trading violations under the US federal securities laws.[51]

- *Regulation FD and Selective Disclosure*

Companies are reminded that they should not selectively disclose MNPI regarding cybersecurity risks and incidents to Regulation FD enumerated persons before disclosing that same information to the public, and any unintentional selective disclosures will require prompt public disclosure in compliance with Regulation FD.

To prepare for a potential incident, companies should ensure they have a protocol in place to quickly inform necessary personnel, including representatives from investor relations, IT, management and internal and outside legal counsel, and to determine the appropriate timing, nature and form of potential disclosures and breach notifications. Key personnel should be trained and kept updated on their responsibilities in the event of a cybersecurity incident and cyber breach simulations can be conducted to test the system for weaknesses and prepare personnel for action in the event of a true incident. Companies should consider adding a technical expert to their sub-certification and/or disclosure committee procedures, or include regular consultation with appropriate technical personnel and trusted advisors.

The National Institution of Standards and Technology ("NIST") Cybersecurity Framework

In April 2018, NIST released an updated cybersecurity framework[52] ("Version 1.1") to clarify and refine its original 2014 framework.[53] Version 1.1 encourages companies to integrate cybersecurity objectives into strategic planning and governance structures and to ensure that cybersecurity is a central part of overall risk management. It also provides new guidance on how to use the framework to conduct self-assessments of internal and third-party cybersecurity risks and mitigation strategies, includes an expanded discussion of how to manage cyber risks associated with third parties and supply chains, advances new standards for authentication and identity proofing

49 The SEC's action is available here.

50 The rule requires investment firms to maintain an up-to-date program for preventing identity theft that provides "red flags" or other warning signs when hackers might be trying to steal customer information. The complete rule is available here.

51 *See,* for example, a recent SEC enforcements against a software engineer at Equifax for trading in the company's securities based on confidential information he received while creating a website for consumers impacted by the company's 2017 data breach that exposed the personal information of approximately 148 million customers. The SEC's action is available here. For more information, see our prior alert, "SEC Insider Trading Charges Against Equifax Insider Highlight Need for Proper Policies and Procedures Related to Cybersecurity and Insider Trading."

52 Available here.

53 Available here.

protocols, and addresses how to apply the framework to a wide range of contexts. The framework provides a useful tool to guide and benchmark company approaches to cybersecurity risk and may impact how regulators evaluate cybersecurity programs and incident responses across sectors.

Part III: Disclosure Considerations and Regulatory Developments and Updates

PCAOB Auditing Standard 3101[54] and Related Guidance

In October 2017, the SEC unanimously approved[55] the Public Company Accounting Oversight Board's ("PCAOB") new auditing standard, AS 3101, and related amendments (collectively, the "New Standard"), which requires an auditor's report to disclose the communication of critical audit matters ("CAMs") [56] arising from the current period's audit, or to state that the auditor determined that there were no CAMs for that period. For any CAMs, the auditor must disclose in its report the principal considerations that led the auditor to determine that the matter is a CAM and how the CAM was addressed in the audit, and must refer to the relevant financial statement accounts or disclosures.[57] [58]

CAM requirements will be phased-in for large accelerated filers for audits relating to fiscal years ending on or after June 30, 2019, and for all other companies for audits relating to fiscal years ending on or after December 15, 2020. Auditors may voluntarily comply early. CAM requirements will generally apply to all audit reports filed with the SEC, but will not apply to audit reports of emerging growth companies ("EGCs"), certain brokers and dealers, investment companies other than business development companies and benefit plans.

In preparation for compliance, given the complexity and sensitivity of the issues involved, companies should consider: (i) starting to work with auditors now to understand their approach and anticipated disclosures; (ii) establishing a process for receiving timely notification from the auditors of any intention to disclose a CAM and the information that the auditor intends to include in its report about the matter (and, once the New Standard is implemented, ensuring sufficient time is allocated for the audit committee, other executives and legal counsel to discuss and review the auditor's report); (iii) monitoring disclosures, as disclosure of a CAM in the auditor's report could result in the disclosure of original information, which may compel the company to provide its own disclosure along with any relevant context or perspective; and (iv) enhanced proxy disclosure regarding the benefits of having a long-term relationship with their auditor, if applicable, as well as how the audit committee monitors auditor independence.

In addition, companies should consider performing a "dry run" to assess potential CAMs and related disclosure, either by conducting a hypothetical review of the prior year's audit, or doing a test run of the current year's audit, to better understand the auditor's approach to the CAM requirements in the context of the particular company, what matters may merit this designation and what disclosures the auditors would anticipate making in their reports. These hypothetical disclosures can then be discussed with the audit committee.

54 For more information, see our prior alert, "SEC Approves PCAOB's New Audit Report Standard to Enhance the Relevance of the Auditor's Report to Investors and Other Market Participants."

55 Available here.

56 A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (i) relates to accounts or disclosures that are material to the financial statements; and (ii) involved especially challenging, subjective, or complex auditor judgment. The New Standard includes guidance for auditors in determining whether a matter rises to the level of a CAM due to its involving especially challenging, subjective, or complex auditor judgment.

57 The New Standard also implemented content requirements and formatting changes to improve the utility, organization and readability of auditor reports. These changes are effective for all audits relating to fiscal years ending on or after December 15, 2017.

58 The PCAOB released guidance, including an annotated example of the new auditor's report highlighting the key changes, followed by explanations, to aid auditors in complying with the new standard. In July 2018 the Center for Audit Quality released guidance on how to determine whether a matter is a CAM, making clear that "the determination of whether a matter is a CAM is principles based, and the new standard does not specify that any matter(s) would always be a CAM. When determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor takes into account certain non-exclusive factors (as specified in the new standard), such as the auditor's assessment of the risks of material misstatement, including significant risks."

Cybersecurity

See above for a discussion of disclosure considerations related to cybersecurity.

Possible Updates to Risk Factor Disclosures

When reviewing risk factors for this reporting season, companies should consider:

Cybersecurity

Recent SEC guidance, as well as enforcement actions at Yahoo, Equifax and Voya (see above), emphasize that cybersecurity poses both economic and security threats that can impact any company. Material cybersecurity risks must be disclosed to avoid potential incomplete or misleading disclosures and companies should carefully analyze whether they need new, revised or expanded cybersecurity disclosure, particularly to demonstrate that the company is aware of the significant potential impact of cyber risks. In addition, companies should consider whether any other specific disclosure with respect to cyber risks associated with suppliers, acquisition targets, etc., as applicable, might be warranted.

GDPR

The European Union's General Data Protection Regulation (GDPR), which became effective in 2018, could be a material issue for many companies. Compliance with the GDPR could require changes to a company's business practices, affect a company's ability to expand internationally or into additional lines of business and subject companies to sizable financial penalties, all of which could materially adversely affect the company's profitability and outlook.

Political Changes

Changes and potential changes in law, regulation and policy may necessitate modifications to risk factor disclosure for certain companies. Some examples include: tariffs (imposed or threatened) on imports, as well as possible retaliatory tariffs imposed on US exports; potential or actual withdrawal or modification of international trade agreements; modifications to sanctions imposed on other countries; changes to immigration policies that may present risks to companies that rely on foreign employees or contractors; and changes in tax or environmental policies that could also require risk factor disclosure.

Tax Reform

Companies should consider whether disclosure regarding potential risks, including application and uncertain implementation, associated with 2017's tax reform (the "Tax Act")[59] is appropriate. See below for a discussion of additional guidance on Section 162(m) of the Internal Revenue Code and accounting guidance related to the application of the Tax Act.

Climate Change and Sustainability

Issues related to climate change and sustainability have been receiving increased attention, and risk factor disclosure could be necessary to address the impact of existing or pending legislation on a company's business, as well as the effects of increased public consciousness and activism related to climate change and sustainability issues. Potential changes in climate regulation could also pose specific risks to certain companies.

London Interbank Offered Rate ("LIBOR")

Recent guidance has indicated that LIBOR will be phased out by the Bank of England entirely, or by regulators as a reference rate for lending transactions, by the end of 2021. Companies with floating rate obligations often benchmark those obligations to LIBOR and the market has only recently begun to build into documentation provisions that contemplate amendments to allow for a replacement rate. Most such provisions do not specify a replacement rate but, instead, allow a borrower and a majority in interest of the lenders to determine the appropriate replacement at the time of the phase-out of LIBOR, and the ultimate new benchmark rate may be

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59 The official title of the bill is "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." The full bill is available here.

higher or lower than LIBOR. Companies should review the scope of their obligations that are benchmarked to LIBOR and assess the materiality of the impact of these potential changes. To the extent that such impact rises to the requisite level of materiality, companies will need to describe the implications of the phase-out on their business, including any associated risks, to investors.

Brexit

On March 29, 2019, the UK is scheduled to officially leave the EU.[60] While final negotiations are still underway and the full effect of the UK's withdrawal from the EU may not be seen for several years, SEC Chair Clayton indicated that the SEC may be sharpening its focus on companies' disclosures about the risks associated with Brexit.[61] Approximately 817 companies disclosed Brexit-related risk factors in their Form 10-Ks filed between September 1, 2017, and September 1, 2018. Brexit has been referenced in risk factors on currency exchange rate risks, cross-border trade and labor, international operations risks and global economic conditions, and risks related to political and regulatory uncertainty. As Brexit negotiations progress, impacted companies should continue evaluating whether Brexit poses a material risk to their business, what level of Brexit-related disclosure is appropriate and whether any prior Brexit risk factor disclosures require updates. Disclosure should be carefully tailored, not boilerplate, and include any specific impact on supply chain, allocation of personnel, and other company-specific considerations. Note that for some companies, 10-Q disclosure may also be warranted (e.g., any issues that are being discussed with the board).

Shareholder Activism

There has been an increase in the number of companies including shareholder activism as a risk factor (in the first three quarters of 2018, 97 companies included such a risk factor, compared to 21 in 2015), either as standalone risk factor describing how the company's business could be impacted by the actions of activist shareholders (such as by causing the company to incur substantial costs, including litigation, diverting management attention and resources, or creating uncertainty that impacts retention of employees or customers), or by adding it to a list of factors that could hinder investment or other business activities and impact a company's stock price.

Perquisite Disclosure

Perquisite disclosure has recently come under focus at the SEC with its issuance of a cease-and-desist order finding that The Dow Chemical Company's disclosure of executive perquisites in several of its annual proxy statements understated the disclosed perquisites and omitted disclosure of approximately $3 million worth of perquisites received by its CEO that should have been disclosed as "other compensation" in the Compensation Discussion & Analysis section of such proxy statements.[62] [63]

In its 2006 adopting release, the SEC provided a principles-based framework to help make a determination as to what constitutes a disclosable perquisite. This framework is based on the following two-step analysis: (1) An item is not a perquisite or personal benefit if it is "integrally and directly" related to the performance of the executive's duties; (2) Otherwise, an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.

It is important for companies to ensure that any benefits provided to executive officers are evaluated under the appropriate disclosure standard and that adequate procedures are put in place to ensure all perquisites are properly approved and disclosed. This should include: (i) having the compensation committee approve any

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60 This will begin the 21-month transition period, during which time most aspects of UK membership in the EU will remain in place.

61 *See* speech given to the FEI Current Financial Reporting Issues Conference (Nov. 12, 2018) and related Wall Street Journal article, available here.

62 The SEC's position was that Dow failed to properly include the following items as perquisites: the use of the company aircraft for personal purposes including travel to outside board meetings and sporting events; club memberships; use of personal assistant time; and membership fees to sit on the board of a charitable organization. The SEC reiterated that the "integrally and directly" related exception is "narrow" and only applies to items that an executive "needs […] to do the job."

63 For more information, see our prior alert, "The Consequences of Inaccurate Perquisite Disclosure."

perquisites to be received by executive officers in advance, (ii) ensuring that there are appropriate controls and procedures to track perquisites provided to executive officers and their usage, and (iii) confirming that the methodology being applied for calculating the aggregate incremental cost of perquisites is consistent with SEC requirements.

Inline XBRL

In June 2018, the SEC adopted amendments mandating the use of Inline XBRL (data tagging embedded directly in the text of an HTML document) for the submission of financial statement information for operating companies, rather than the current format in which XBRL data is provided solely as exhibits to company filings.[64] Filings will also include an exhibit containing contextual information about the XBRL tags embedded in the filing. Effective as of September 17, 2018, filers are also no longer required to post Interactive Data Files on their websites. There are also conforming changes to the cover pages to certain periodic reports, as discussed below.

The SEC anticipates modifying the EDGAR system to accept submissions in Inline XBRL for all forms in March 2019. Operating companies will be permitted to file using Inline XBRL when EDGAR has been updated. For large accelerated filers that use US GAAP, compliance will be required beginning with fiscal periods ending on or after June 15, 2019. For accelerated filers that use US GAAP, compliance will be required beginning with fiscal periods ending on or after June 15, 2020. For all other filers, compliance will be required beginning with fiscal periods ending on or after June 15, 2021.

Disclosure Simplification (DUSTER)[65]

In August 2018, the SEC adopted amendments[66] to eliminate or modify certain disclosure requirements that have become duplicative, overlapping or outdated in light of other SEC disclosure requirements, US GAAP or "changes in the information environment." The amendments are intended to simplify and update disclosure and reduce compliance burdens for companies, without significantly altering the total mix of information available to investors.[67]

These rule changes went into effect on November 5, 2018. As the rule changes include amendments involving Regulation S-K and Regulation S-X and will impact periodic filings, it is particularly important for companies to perform a form check when preparing their upcoming filings, including annual reports on Form 10-K and the financial statements contained therein.

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64 For more information, see our prior alert here.

65 The SEC Staff issued C&DI 105.09 to clarify the effectiveness of the Disclosure Simplification Rules as they relate to the changes in shareholders' equity. Specifically, C&DI 105.09 explains that the SEC Staff will allow a company to defer inclusion of information regarding changes in shareholders' equity until the company files its quarterly report covering the period that begins after the effective date of the Disclosure Simplification Rules.

66 The final rules can be found here. The changes include, among others: (i) eliminating the requirement to disclose certain information in the Description of Business section, including segment information, research and development spending and certain geographic information; (ii) replacing requirement to disclose high and low sales prices for common equity listed on a US exchange for each full quarterly period within the two most recent fiscal years with requirement to identify the principal US markets where each class is traded; (iii) eliminating requirement to disclose in Form S-1 or Form 10 the amount of common equity subject to outstanding options, warrants or convertibles when the class of common equity has no established US public trading market; (iv) eliminating requirement to disclose frequency and amount of cash dividends declared and restrictions likely to materially affect the issuer's ability to pay dividends; (v) eliminating requirement to disclose seasonal aspects of business in MD&A in interim reports; retained requirement to disclose seasonality at the segment level if material to business as a whole; (vi) eliminating requirement to disclose historical and pro forma ratios of earnings to fixed charges and/or preference dividends; and (vii) eliminating various exhibits. For more information, see our prior alert, "SEC Adopts Amendments to Simplify and Update Disclosure Requirements."

67 The SEC also referred certain disclosure requirements to the Financial Accounting Standards Board ("FASB") for potential incorporation into GAAP.

Change to the Definition of "Smaller Reporting Company"[68]

In June 2018, the SEC unanimously voted to amend the definition of "smaller reporting company" ("SRC") to allow more companies to take advantage of the scaled disclosures permitted for companies that meet the definition. Most significantly, the amendments raise the SRC cap to less than $250 million in public float and include as SRCs companies with less than $100 million in annual revenues if they also have either (i) no public float or (ii) a public float that is less than $700 million. The SEC also approved conforming amendments to the definition of "accelerated filer" in Rule 12b-2 under the Exchange Act to provide that notwithstanding the fact that companies with $75 million or more of public float may now qualify as SRCs, such companies will remain subject to the requirements applicable to accelerated filers, including the accelerated timing of filing of periodic reports and the requirement to provide an auditor's internal control attestation under Section 404(b) of the Sarbanes-Oxley Act of 2002 ("SOX").[69]

In connection with these updates, Corp Fin updated certain C&DIs and withdrew several other C&DIs.[70] The updated C&DIs clarify:

- that under the new amendments, companies can be both accelerated filers and SRCs, meaning they can use the scaled disclosure rules for SRCs but their periodic reports are due under the timeline for accelerated filers and they must provide SOX 404(b) auditor attestation reports in their Form 10-Ks (Question 102.01);
- the circumstances under which a reporting company that fails to qualify as an SRC can later qualify if its revenues or public float decreases[71] (Question 102.02);
- that in determining whether a company is an SRC, the company's annual revenues should be calculated on a consolidated basis (Question 202.01); and
- that a company that qualifies as an SRC for purposes of its 2019 Form 10-K can use SRC disclosure for its proxy statement, and incorporate Part III information into its 2019 10-K from the proxy statement, even if the company will no longer qualify as an SRC in 2020 (Question 104.13).

Changes to Form 10-K Cover Page as a Result of Inline XBRL and Expanded SRC Definition[72]

The new SRC rules include conforming amendments to the cover pages for registration statements on Forms S-1, S-3, S-4, S-8, S-11 and Form 10 and periodic reports on Forms 10-K and 10-Q, reflecting the higher threshold for SRC status but the unchanged "accelerated filer" definition. These forms have been revised as follows:

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68 The SEC Handbook on this change is available here. For more information, see our prior alert "New and Proposed Rules on Smaller Reporting Companies, XBRL and Whistleblower Program."

69 In October 2018, the NYSE amended Section 303A.00 of its Listed Company Manual to conform the threshold for companies to qualify for the exemptions from the NYSE corporate governance requirements applicable to SRCs to these changes. Amended Section 303A.00 simply states that an SRC that fails to meet the requirements for SRC status as of the last business day of its second fiscal quarter will cease to be an SRC as of the beginning of the following fiscal year. Therefore, all companies that qualify for SRC status under the revised SEC definition will qualify for those exemptions.

70 The withdrawn C&DIs include four that addressed transition issues for SRCs (Exchange Act Rules C&DIs 130.04, 169.01, 169.02 and 169.03), as well two obsolete C&DIs relating to old Regulation S-B (Section 110. Item 303: MD&A C&DI 110.01) and a misstatement in the original SRC adopting release concerning when SRCs would have to provide audit committee financial expert disclosure (Section 133. Item 407: Corporate Governance C&DI 133.09).

71 Under the new rules, once a reporting company fails to qualify as an SRC, it will remain unqualified until, when making a subsequent annual determination, it meets other lower caps set at 80 percent of the initial qualification caps. That is, either: (i) it determines that its public float is less than $200 million; or (ii) it determines that: (1) for any threshold that it previously exceeded, it is below the subsequent annual determination threshold (public float of less than $560 million and annual revenues of less than $80 million); and (2) for any threshold that it previously met, it remains below the initial determination threshold (public float of less than $700 million or no public float and annual revenues of less than $100 million).

72 For more information, see our prior alert here.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company", and "emerging growth company" in Rule 12b 2 of the Exchange Act:

Large accelerated filer [ ] Accelerated filer [ ]

Non accelerated filer [ ] ~~(Do not check if a smaller reporting company)~~ Smaller reporting company [ ]

Emerging growth company [ ]

In addition, the new Inline XBRL rules include conforming amendments to the cover pages for certain periodic reports, including Forms 10-K and 10-Q, to eliminate references to compliance with the website posting requirement.

The cover pages of Forms 10-K and 10-Q have been revised as follows:

Indicate by check mark whether the registrant has submitted electronically ~~and posted on its corporate Web site, if any,~~ every Interactive Data File required to be submitted ~~and posted~~ pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit ~~and post~~ such files).

The changes related to the new SRC rules are effective as of September 10, 2018. While there is a phase in period for required use of Inline XBRL, the elimination of the website posting requirements and the related changes to the cover page are effective as of September 17, 2018.

Quarterly Reporting

Evaluation of Continued Quarterly Reporting Requirements

There has been a recent focus on whether quarterly reporting promotes short-termism and increases pressure on companies to focus on quarterly results rather than longer-term value creation, and how to best balance this with investors' interest in quarterly information. Corp Fin has indicated that it will examine the issue and look at ways to ease compliance burdens while maintaining appropriate levels of disclosure and protecting investors' interests.

Impact of Disclosure Update and Simplification Initiative Changes on Stockholders' Equity Disclosures

In limited circumstances, the amendments adopted as part of the SEC's disclosure simplification initiative (discussed above) may expand disclosure requirements related to interim disclosures about changes in stockholders' equity and noncontrolling interests ("changes in stockholders' equity"). For filings on Form 10-Q, the amendments extend to interim periods the annual requirement in Regulation S-X, Rule 3-04[73] to disclose (1) changes in stockholders' equity and (2) the amount of dividends per share for each class of shares (as opposed to common stock only, as previously required).[74]

Under the amended rules,[75] registrants must now analyze changes in stockholders' equity, in the form of a reconciliation, for "the current and comparative year-to-date [interim] periods, with subtotals for each interim period." Registrants should therefore include a reconciliation for the current quarter and year-to-date interim

73 Regulation S-X, Rule 3-04, "Changes in Stockholders' Equity and Noncontrolling Interests."

74 The requirement to disclose changes in stockholders' equity applies regardless of whether a registrant presents noncontrolling interest in accordance with ASC 810.3 *See* FASB Accounting Standards Codification Topic 810, Consolidation.

75 Regulation S-X, Rules 8-03(a)(5) and 10-01(a)(7).

periods as well as the comparative periods of the prior year (i.e., a reconciliation covering each period for which an income statement is presented.[76]

The final rule is effective for all filings submitted on or after November 5, 2018. The SEC subsequently published a C&DI[77] which provides some relief to registrants that file Form 10-Q shortly after the final rule's effective date. The C&DI clarifies that the SEC will not object if a filer's first presentation of changes in shareholders' equity is included in its Form 10-Q for the quarter that begins after the November 5, 2018, effective date given that date's close proximity to the filing date for most calendar year-end filers' quarterly reports for the third quarter of 2018.

Pay Ratio Disclosure

Mandatory pay ratio disclosure debuted during the 2018 proxy season.[78] The pay ratio disclosure rule (the "Rule") requires disclosure of how the median pay of a company's workforce compares to the compensation of its chief executive officer and applies to each of a company's registration statement, proxy and information statement and annual report that is required to disclose information on executive compensation pursuant to Item 402 of Regulation S-K. The Rule gives companies flexibility to select a method for identifying the median employee that is appropriate to the size and structure of their businesses and compensation programs. Companies are allowed to identify the median employee based on any consistently applied compensation measure, such as compensation amounts reported in their tax and/or payroll records.

While significant effort was required in order to prepare for compliance, pay ratio disclosure did not have a meaningful impact on investor voting. To date, institutional investors have generally expressed ambivalence with respect to these disclosures; for example, BlackRock indicated that it does not intend to use these ratios to inform its voting or engagement. However, in response to ISS's 2018 policy survey, nearly three-quarters of the investor respondents indicated that they intend to assess year-over-year changes in the ratio at an individual company, compare the ratios across companies/industry sectors, or both.[79] The scope of disclosures during the 2019 proxy season is expected to remain largely unchanged, as investors do not appear to be looking for additional alternative ratios or further explanations in this area.

Revisions to Rule 701 and Form S-8

Rule 701 provides an exemption from registration for securities issued by non-reporting companies for compensatory purposes to certain eligible recipients, including company employees, officers, directors, partners, trustees, consultants and advisors. In July 2018, the SEC issued final rules raising the threshold value that triggers the requirement to deliver additional disclosure to investors when an unlisted issuer[80] issues securities pursuant to a compensatory arrangement in reliance on an exemption from the registration requirements under Rule 701. If a company's issuances exceed the new $5 million threshold, the company is required to provide more robust disclosures, including a summary of the compensatory plan or arrangement, financial statements dated not more than 180 days before the sale and a list of risk factors associated with the securities.

In addition, the SEC issued a concept release soliciting comments on ways to modernize its rules related to compensatory securities offerings in light of various recent developments, such as the proliferation of the so-called "gig economy" ,[81] by updating the requirements of Rule 701 and Securities Act Form S-8,[82] including:

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76 Both rules refer to Rule 3-04 for presentation requirements, which, among other items, include a reconciliation that describes all significant reconciling items in each caption of stockholders' equity and noncontrolling interests (if applicable). Rule 3-04 permits the disclosure of changes in stockholders' equity (including dividend-per-share amounts) to be made either in a separate financial statement or in the notes to the financial statements.

77 Question 105.09 of the Exchange Act Forms C&DIs.

78 For more information, see our prior alert "SEC Adopts Final Rules on CEO Pay Ratio Disclosure."

79 See ISS, 2017-2018 ISS Global Policy Survey—Summary of Results, available here.

80 May include private domestic companies and foreign private issuers listed in their home jurisdictions.

81 The "gig economy" is made up of short-term, part-time or freelance workers.

82 For more information, please see our prior alert, "SEC Amends Rule 701 and Solicits Public Comments on Further Changes to Rule 701 and Form S-8 in a Concept Release."

- Expanding Rule 701 to allow use by public companies; revising the rule's content and timing requirements; modifying or eliminating annual sales caps under Rule 701(e); addressing restricted stock units ("RSUs");[83] and increasing availability to non-traditional workers (short-term, part-time, and freelance workers).

- Increasing the availability of Form S-8 for securities issued to non-traditional workers; simplifying requirements (including whether a specific amount of shares should be required to be disclosed, how additional shares may be added to Form S-8, allowing issuers to register on a single form offers and sales pursuant to all of their employee benefit plans); providing resale of restricted or control shares issued under employee benefits plans via Form S-3; and implementing a "pay-as-you-go" fee structure for Form S-8 registration fees. The SEC has also considered eliminating Form S-8 altogether and allowing public companies to rely on Rule 701.

New Guidance on Section 162(m)

Section 162(m) of the Internal Revenue Code limits the deductibility of annual compensation paid to certain "covered employees" of a publicly held corporation to $1 million per executive. The Tax Act modified §162(m) in a number of material ways,[84] including eliminating the exemption for performance-based compensation and broadening the definition of "covered employees." In August 2018, the Treasury Department and the Internal Revenue Service ("IRS") released Notice 2018-68[85] to provide initial limited guidance clarifying the definition of "covered employee"[86] and when grandfather status[87] will be afforded to written binding contracts previously in effect. Additional IRS guidance is expected in the future.

Companies should continue to review their existing incentive plans and agreements to determine whether any changes should be made to such arrangements as a result of the guidance. Companies should continue to maintain a compensation committee of §162(m)-qualified outside directors in order to certify performance results for grandfathered performance-based arrangements. However, companies should expect to update their compensation committee charters to eventually eliminate references to the §162(m) performance-based requirements. The elimination of the performance-based exemption removes a tax incentive for the grant of stock options. However, it is expected that most companies that currently utilize stock options will continue to do so, as companies generally grant options because they view them as an appropriate retention and motivation tool, rather than because of any potential tax treatment. Finally, companies no longer need to (i) have cash bonus plans approved by shareholders, (ii) include performance goals in their equity plans or (iii) obtain shareholder approval of applicable performance goals every five years. It should be noted that even though the tax deductibility of qualified performance-based compensation will no longer be available, most companies will still choose to

83 RSU's have become increasingly common since Rule 701 was last substantively amended. Unlike options or other derivative securities (for which disclosure under Rule 701 must be delivered a reasonable time before exercise or conversion), RSUs settle without the recipient making an investment decision, meaning that the investment likely takes place at the date of grant. Consequently, the issuer's obligation to provide Rule 701(e) disclosure would be a reasonable period of time before the date the RSU is granted, which may result in a delivery obligation at a time when employment agreements are being negotiated. The concept release seeks comments regarding whether Rule 701 should be amended to specifically address the timing of Rule 701(e) disclosure for RSUs or similar instruments, and whether timing requirements should be different for new hires. The concept release also seeks to clarify how RSUs should be valued for Rule 701 purposes.

84 See our prior alert, "Compensation Season 2018: Section 162(m) and Related Considerations Post-Tax Reform."

85 See our prior alert, "Initial Guidance on Recent Changes to Section 162(m) Covered Employees and Grandfather Rule."

86 The Tax Act expanded the definition of "covered employees" for purposes of §162(m) to include (1) the CFO; (2) any employee whose total compensation is among the three highest compensated officers for the taxable year (excluding the CEO and CFO); and (3) any executive who was a "covered employee" for any tax year beginning after December 31, 2016.

87 The Tax Act's changes to §162(m) do not apply to compensation under written binding contracts in effect as of November 2, 2017, so long as the contracts are not materially modified thereafter. Companies are allowed to deduct compensation (i) under performance-based arrangements in effect on November 2, 2017, including existing stock options and other performance-based equity awards, (ii) for amounts earned and deferred under deferred compensation arrangements as of November 2, 2017 and (iii) under arrangements in effect on November 2, 2017 with CFOs and any individual who would first be covered by §162(m) solely due to the changes to §162(m) under the Tax Act.

maintain performance-based compensation programs in order to appropriately incentivize executives and respond to the demands of pay-for-performance by proxy advisory firms and shareholders.

Accounting Impact of Tax Reform

SEC Staff Accounting Bulletin No. 118 ("SAB 118") provides guidance on disclosures related to the accounting impact of the Tax Act by setting forth a three-part procedure for companies to follow when accounting for and reporting the income tax effects of the Tax Act in financial statements that include a reporting period in which the Tax Act was enacted. When preparing 2019 financial statements, companies should continue to take into account the guidance of SAB 118, including the requirements to include narrative explanations necessary to provide information about the material financial reporting impact of the Tax Act. In particular, companies should consider whether they have more information regarding the effect of the Tax Act than they included previously.

NYSE/Nasdaq Updates

Amended NYSE Requirements Regarding Physical Delivery of Proxy Materials

In March 2018, the SEC approved an amendment[88] to Section 402.01 of the NYSE Listed Company Manual such that listed companies will not be required to provide hard copies of their proxy materials to the NYSE, *provided* those materials are included in an SEC filing available on EDGAR. Under amended Section 402.01: (i) listed foreign private issuers and domestic companies that file their proxy materials on EDGAR but on forms other than Schedule 14A, only need to provide the NYSE in electronic format the information sufficient to identify its filing no later than the date proxy materials are distributed to stockholders, and (ii) any listed company whose proxy materials are not included in their entirety (including the proxy card) in a filing on EDGAR is required to provide three physical copies of any proxy materials not available on EDGAR to the NYSE no later than the date proxy materials are distributed to stockholders.

NYSE Dividend Notification Requirements

In August 2017, the SEC approved an amendment to the NYSE Listed Company Manual requiring listed companies submitting dividends during or outside of market hours to provide the NYSE with 10 minutes of advance notice before releasing the dividend information to the public. The advance notice requirement for announcements during market hours was effective immediately; however, the NYSE delayed implementation as it relates to announcements issued outside of market hours. The outside market hours notification requirement went into effect on February 1, 2018.[89]

NYSE and Nasdaq Rule Changes Regarding Shareholder Approval of Certain Private Issuances

In September 2018, the SEC approved[90] Nasdaq's proposed change to Rule 5635(d) of the Nasdaq Listing Requirements regarding shareholder approval for certain securities issuances. The new rule:

> (i) changes the definition of market value for purposes of the shareholder approval of transactions (other than public offerings) such that**:** (1) shareholder approval would be required prior to an issuance of 20 percent or more at a price that is less than the lower of the closing price or the five-day average closing price; and (2) shareholder approval would not be required prior to an issuance of 20 percent or more at a price that is less than book value but greater than market value**,** and
>
> (ii) eliminates the requirement for shareholder approval of issuances at a price less than book value but greater than market value.[91]

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88 The SEC's approval notice is available here.

89 *See* the NYSE's annual guidance letter, available here.

90 Available here.

91 Under the previous version of the rule, the threshold for shareholder approval of private security issuances was based on book or market value, with "market value" being defined as the closing bid price. There was concern that bid price may not be transparent to companies and investors and does not always reflect an actual price at which a security has traded.

Similarly, in October 2018, the NYSE proposed[92] to amend Sections 312.03 and 312.04 of the Listed Company Manual to modify the price requirements for purposes of determining whether shareholder approval is required for certain issuances. Like the new Nasdaq rule, the NYSE proposal would:

(i) change the definition of market value for purposes of the shareholder approval rule; and

(ii) eliminate the requirement for shareholder approval of issuances at a price less than book value but greater than market value.[93]

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92 Available here.

93 Under the existing rule, shareholder approval is required for the issuance of common stock in a variety of circumstances: (i) for certain related-party issuances if the issuance exceeds either 1 percent of the number of shares of common stock or of the voting power outstanding before the issuance (Section 312.03(b)); (ii) prior to the issuance of common stock if: **(**1**)** the common stock has, or will have upon issuance, voting power equal to or in excess of 20 percent of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock; or **(**2**)** the number of shares of common stock to be issued is, or will be upon issuance, equal to or in excess of 20 percent of the number of shares of common stock outstanding before the issuance of the common stock or of securities convertible into or exercisable for common stock." (Section 312.03(c)).

Part IV: Future Rulemaking: Looking Ahead

Concept Release Regarding Changes to Rule 701 and Form S-8

See above discussion of proposed changes to Rule 701 and Form S-8.

House Passes "Jobs Act 3.0"

In July 2018, the House passed the "Jobs and Investor Confidence Act of 2018."[94] Among other things, the bill would:

- Require the SEC to analyze the costs and benefits of, and alternative formats for, quarterly reporting for EGCs.
- Direct the SEC to consider amendments to Rule 10b5-1 that would, among other things: limit insiders' ability to use overlapping plans, establish a mandatory delay between the adoption of the plan and execution of the first trade, limit the frequency of plan amendments, require companies and insiders to file plans and amendments with the SEC, and impose board oversight requirements.
- Require companies with multi-class share structures to make certain proxy statement disclosures about shareholders' voting power.
- Allow EGCs with less than $50 million average annual gross revenue to opt out of auditor attestation requirements beyond the typical 5-year period.
- Amend the definition of "accredited investor" to include people with education or job experience that would allow them to evaluate investments.
- Expand to all public companies the "testing the waters" and confidential submission process for registration statements in an IPO or a follow-on offering within one year of an IPO.
- Allow venture exchanges for small and emerging companies to register with the SEC.
- Direct the SEC and FINRA to study the direct and indirect costs for small and medium-sized companies to undertake public offerings.

It is unclear whether any further action will be taken on the bill.

SEC Proposing Release on Amending Auditor Independence Rules

In May 2018, the SEC issued a proposing release[95] to amend the "Loan Rule," part of its auditor independence rules, to refocus the analysis used to determine whether an auditor is independent when the auditor has a lending relationship with certain shareholders of its client at any time during an audit or professional engagement period. The proposed amendments would: (i) focus the analysis solely on beneficial ownership rather than on both record and beneficial ownership; (ii) replace the existing 10 percent bright-line shareholder ownership test with a "significant influence" test; (iii) add a "known through reasonable inquiry" standard with respect to identifying beneficial owners of the client's equity securities; and (iv) amend the definition of "audit client" for a fund under audit to exclude funds that otherwise would be considered affiliates of the client. If the proposed amendments are adopted, an audit firm would still need to establish, and audit committees would still have to assess, the audit firm's independence.

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94 Available here.

95 Available here.

Dodd-Frank Rules

This discussion reflects the current state of pending Dodd-Frank-related disclosure requirements and related rulemaking initiatives.

Pay versus Performance Disclosures

In 2015, the SEC proposed rules that would require companies to disclose the relationship between executive compensation actually paid and the financial performance of the company. The rules have not been finalized and no disclosure changes will be in effect for the 2019 reporting season.

Compensation Clawbacks[96]

In 2015, the SEC proposed rules that would require any company with securities listed on a national securities exchange to have a policy to "claw back" incentive-based compensation paid to current and former executives in the event of a financial restatement to correct a material error.[97] The proposal also specifies disclosure requirements relating to clawback policies and actual clawbacks. The SEC has not issued a final rule; however, there has been a trend favoring the adoption of broader clawback policies that go beyond the scope of SOX requirements (including with respect to the group of covered executives), which trigger clawbacks only when there is fraud or misconduct in connection with a financial restatement. Companies that have a broader clawback policy in place should consider enhancing related disclosures in their 2019 proxy statements.

Employee and Director Hedging Disclosure[98]

In 2015, the SEC proposed rules that would require a company to disclose whether any employees or directors are permitted to hedge their equity securities of the company. The rule has not been finalized and will not impact 2019 reporting; however, anti-hedging positions of proxy advisory and corporate governance rating firms have prompted many companies to prohibit directors and executive officers (and sometimes employees generally) from engaging in hedging transactions with respect to their company's stock. Because there is no universally accepted best practice approach to hedging policies, it is important to analyze what type of policy is in the best interests of the company, taking into account the needs of its insiders, and what types of features could be incorporated to mitigate risk. Companies should also ensure that any disclosure they provide is consistent with their existing policies, rather than merely boilerplate language.

The SEC is expected to focus on finalizing these rules in the near-term and the Staff has recently indicated that the SEC intends to undertake initiatives relating to the other pending Dodd-Frank rulemaking after the hedging rules are finalized.

Evaluation of the Role of Proxy Advisory Firms and Proxy Process

Withdrawal of No-Action Letters Related to Proxy Advisory Firms

In September 2018 the SEC withdrew[99] two no-action letters related to proxy advisory firms, *Egan-Jones Proxy Services* (May 27, 2004) and *Institutional Shareholder Services, Inc.* (Sept. 15, 2004). The now-withdrawn letters essentially allowed the outsourcing of the fiduciary obligation investment advisors owed to their clients (including the obligation to ensure that clients' proxies are voted in the clients' best interests and having procedures to

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96 The proposed rule can be found here.

97 Clawbacks of erroneously awarded incentive-based compensation would be required for the three fiscal years prior to a financial restatement and would be "no fault," meaning they would be triggered regardless of whether an executive was involved in any misconduct or was responsible for the restatement. SRCs, EGCs and companies that list only debt or preferred securities would be subject to the standards to the extent that they have securities listed on a national securities exchange or association. Incentive-based compensation is defined as any compensation (including stock options and other equity awards) that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure.

98 The proposed rule can be found here.

99 The SEC's statement on the withdrawal is available here.

address material conflicts of interest in voting proxies on behalf of clients[100]) to independent proxy advisory firms.[101] The letters were often criticized as having “institutionalized” the role of proxy advisory firms and fueled their overall influence, resulting in an over-reliance on their recommendations. The practical impact of the withdrawal of the letters is difficult to assess, but investment advisors are left with increased uncertainly over the extent to which they can rely on proxy advisors, although it seems unlikely that this will precipitate a fundamental shift in their practices. Notably, both ISS and Glass Lewis issued public statements indicating that they have never relied upon these no-action letters and the withdrawal has no impact on the services they are providing or how investors use their advice.

SEC’s Proxy Roundtable

In November 2018, the SEC hosted a roundtable to hear investor, issuer, and other market participant views about the proxy process and rules, focusing on three specific areas: proxy voting mechanics, regulation of proxy advisers and shareholder proposals and engagement. [102] With respect to voting, the focus was on how to improve the accuracy, transparency and efficiency of the proxy voting and solicitation system mechanics, including through regulatory changes and the use of technology.[103] The shareholder proposal panel focused on exploring effective shareholder engagement, experience with the shareholder proposal process, and related rules and SEC guidance.[104] The proxy advisors panel focused on the role of proxy advisory firms, their involvement in the proxy process, how this role has evolved over time and ways in which their role and relationships with institutional investors and issuers can be improved.[105]

It is unclear what, if any, changes will result from the roundtable, and whether proxy advisors will ultimately be subject to formal regulation.

Proposed Legislation

There have also been congressional initiatives regarding regulation of proxy advisory firms. The House of Representatives passed the “Corporate Governance Reform and Transparency Act of 2017”[106] in December 2017 and the Senate Banking Committee conducted hearings on it in June 2018. In November 2018, the Senate introduced the “Corporate Governance Fairness Act,”[107] a bipartisan bill that would require the SEC to regulate proxy advisory firms under the Investment Advisers Act in order to improve transparency, address conflicts of interest and adopt additional investor protections. While the likelihood of these legislative initiatives passing is unclear, they add to the growing pressure on the SEC to consider regulation of proxy advisory firms.

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100 Rule 206(4)-6 under the Investment Advisers Act of 1940, available here.

101 The conclusion being that, in certain circumstances, an investment adviser could rely on proxy advisory firms, such as ISS and Glass Lewis, as independent third parties for purposes of making proxy voting recommendations, thereby “cleansing” the vote of any conflict on the part of the investment adviser.

102 Commissioner Stein’s opening statement is available here. Commissioner Roisman’s opening statement is available here. Chairman Clayton’s opening statement is available here.

103 Topics included accuracy in vote counts, communication with beneficial owners, universal proxy card, whether blockchain technology should be considered and whether the SEC should start “from scratch” to rebuild the proxy system or focus on making improvements to the existing system.

104 Topics included the propriety of initial and resubmission threshold levels and the SEC’s guidance provided in SLB 14H and recent “direct conflicts” no action letter responses.

105 Topics included “robo-voting”, conflicts of interest, correcting the record when there are errors in the proxy advisors’ analyses and proxy advisor registration.

106 Available here.

107 Available here.

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