**Client Alert** | US Public Company Advisory

# Reminders for Foreign Private Issuers for the 2019 Annual Reporting Season

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## Executive Summary

This memorandum outlines considerations for foreign private issuers ("FPIs") in preparation for the 2019 annual reporting season. Part I (pg. 2) provides a summary of certain key trends and insights from the 2018 US proxy season that may be of relevance to FPIs; Part II (pg. 4) sets forth an overview of recent corporate governance developments and trends; Part III (pg. 8) examines disclosure considerations and regulatory updates; and Part IV (pg. 14) includes a brief discussion of upcoming regulatory developments and pending rulemaking initiatives.

## Part I: 2018 US Proxy Season – Insights and Trends[1]

FPIs are exempt from US proxy rules, including the ability of shareholders to submit so-called Rule 14a-8 proposals. As a result, many FPIs have been largely immune from the shareholder activism faced by their US counterparts. Nevertheless, FPIs frequently have the same institutional investors as US domestic issuers and those investors are increasingly raising the same issues with FPIs as they raise with US domestic issuers. US companies experienced an active proxy season in 2018. While the total number of shareholder proposals submitted declined slightly from 2017; average support for proposals voted on increased, suggesting increased shareholder engagement generally and increased traction among institutional investors. In light of these trends, FPIs should be aware of the need for increased shareholder engagement and consider the corporate governance trends that are impacting US domestic issuers. It is likely only a matter of time before many of these trends impact FPIs to the same extent as their US counterparts.

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1 For a more detailed discussion of the 2018 US proxy season results and trends, see our alert, "Reminders for US Public Companies for the 2019 Annual Reporting and Proxy Season."

## 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 US governance proposal landscape in 2018:

- Most special meeting proposals focused on lowering the threshold percentage of shares required to call a special meeting (from 25 percent to 10 percent); a few sought to introduce the right at companies where it is not offered.[2] Institutional investors are generally supportive of giving shareholders the right to call a special meeting. Seven of the special meeting proposals passed out of a total 77 submitted.

- There was a significant increase in proposals to allow shareholders to act by written consent; however, shareholder support remained low, with only five proposals passing out of a total 41 submitted. As 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 seem to reflect agreement by a majority of shareholders that special meeting rights render written consent rights unnecessary. Corporate law in non-US jurisdictions often permits shareholder action by written consent only with 100 percent shareholder approval; thereby rendering the issue non-applicable.

- There were significantly fewer proposals to adopt proxy access in 2018[3]; and 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,[4] fewer proposals to adopt proxy access went to a vote in 2018. In addition, "fix it" proposals seeking to amend existing proxy access terms (mainly to remove or loosen restrictions on group size), continued to be unsuccessful. The relevance of this trend of allowing shareholders to include proposals in the company's proxy statement will depend on the corporate law of the jurisdiction of incorporation of an FPI.

## Social Proposals

The number of social proposals submitted by shareholders in the US in 2018 increased slightly relative to 2017, with the two largest sub-categories being lobbying/political contributions and diversity-related proposals (board, employment and gender pay gap). However, fewer gender pay equity, equal employment opportunity and board diversity proposals went to a vote, as many were withdrawn after companies reached agreements with shareholders:

- Proposals seeking disclosure related to a company's spending on political contributions and lobbying were the most common type of social proposal in the US in 2018.[5] Although none passed, many received more than 30 percent support; and several proposals were withdrawn, likely due to corporate engagement with the proponents.

- 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. These proposals averaged less than 20% percent support, but shareholders are increasingly focusing on this issue.

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[2] 60 percent of S&P 500 companies currently offer shareholders a right to call special meetings.

[3] 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. Almost 80 percent of all shareholder proposals are received by S&P 500 companies. Proxy access refers to a company allowing its shareholders that have held a specified number of shares for a designated length of time to include a shareholder proposal in the company's proxy statement, thereby lowering that shareholder's cost of proposing an item for inclusion in the company's proxy statement.

[4] 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.

[5] Many 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. *See* The 2018 CPA-Zicklin Index of Corporate Political Disclosure and Accountability, available here.

- Proposals related to board diversity remained relatively stable in 2018; but board diversity issues, especially with respect to women and minorities, have garnered increased attention in the US corporate governance arena. Only five proposals out of a total of 30 submitted went to a vote, as a significant number were withdrawn, typically after companies reached agreements with the proponents. The proposals that were voted on averaged a 22.5 percent support rate, and none passed; however, campaigns for gender diversity on boards have already had an impact on board composition and recruitment,[6] and gender and minority board diversity is likely to remain an important topic for the 2019 proxy season as investors and regulators continue focusing on this issue.[7]

### Environmental Proposals

Fewer environmental proposals reached a vote in 2018, 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:[8]

- Climate change proposals were the most prevalent type of environmental proposal (one-third of all the environmental proposals that went to a vote), with continued high levels of shareholder support. These proposals averaged 32 percent support in 2018, similar to 2017 levels; more than half received greater than 30 percent support, with four passing out of a total 71 submitted. 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.

## ISS and Glass Lewis Proxy Voting Guidelines

Proxy advisory firms, such as Institutional Shareholder Services, Inc. ("ISS") and Glass Lewis & Co. ("Glass Lewis"), can have a significant impact on the proxy voting process, since the voting recommendations of these firms often determine or influence shareholder votes. As a result, it is important for publicly traded companies to evaluate their corporate governance practices against the proxy voting policies and guidelines established by these firms. Both ISS and Glass Lewis provide country or region-specific guidance[9] which companies should carefully review and consider as they prepare for their 2019 shareholder meetings.

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6 Equilar reports 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 that, for the second consecutive year, women and minorities represented half the class of new S&P 500 directors in 2018. Equilar's Q2 2018 Gender Diversity Index can be found here and the 2018 US Spencer Stuart Board Index Highlights is available here.

7 Including: (i) the SEC, with its voluntary "Diversity Assessment Report"; (ii) the New York City Comptroller/New York City Pension Funds, with its "Board Accountability Project 2.0" to encourage disclosure of board diversity in a standardized matrix; (iii) BlackRock, which expects at least two women directors on every board; (iv) State Street Global Advisors, which, starting in 2020, will generally vote against the nominating committee of a company without at least one woman on its board; (v) CalPERS, which adopted a "Board Diversity & Inclusion" voting enhancement to hold directors accountable for failure to improve diversity on their boards or diversity and inclusion disclosures; (vi) the state of California, which passed a law requiring 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 (with increasing thresholds thereafter); and (vii) proxy advisory firms ISS and Glass Lewis, which updated their voting guidelines with respect to board gender diversity for 2019.

8 Two asking for preparation of a two-degree scenario; one seeking a report on coal ash risk; one seeking a report on methane emissions management; one asking for a sustainability report; and one asking a company to set GHG emissions reduction goals.

9 ISS guidelines are available here and Glass Lewis guidelines are available here.

## Part II: Corporate Governance Developments

### Board Oversight of Risk Exposure

Oversight of Social Media Risk; Disclosure Controls Impact

The SEC's recent action against Tesla and its CEO[10] highlights the importance of having disclosure controls and procedures for *all* corporate communications and underscores the SEC's focus on communications from a public company and its leadership in any form. Accordingly, all communications made on behalf of a public company must be vetted as carefully as traditional modes of communication, such as SEC filings. Public companies should have formal disclosure controls and procedures in place around all corporate communications as well as a written disclosure policy that specifically 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). While Regulation FD does not, by its terms, apply to FPIs, it nonetheless codifies requirements that the SEC believes arise out of the antifraud provisions of the US securities laws. FPIs usually comply with Regulation FD as a matter of best practice.

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.[11] In February 2018, the SEC issued an interpretive release[12] providing

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10 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 US$20 million penalty, to be distributed to harmed investors under a court-approved process. The SEC's statement on the settlement is available here.

11 84 percent of Fortune 100 companies disclosed in their proxy statement or 10-K that at least one board-level committee was designated with oversight of cybersecurity matters. At the same time, around 25 percent identified one or more "point

guidance (the "Cybersecurity Guidance") to assist public companies in preparing disclosures about cybersecurity risks and incidents.[13] 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[14] 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.[15] Boards should receive periodic updates from management and any relevant expert advisors on the company's compliance with applicable standards.[16] 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.[17] 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 chief information security officer 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.

## Disclosure Considerations

The SEC is focused on timely and accurate disclosure, as illustrated by its recent enforcement case against Yahoo[18] 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

persons" on cyber among the management team (e.g., the chief information security officer or chief information officer). *See* EY Center for Board Matters "Cybersecurity Disclosure Benchmarking", available here.

12 Available here.

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

14 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.

15 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.

16 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.

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

18 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."

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:

### 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[19] against Voya Financial Advisors for violating the "Identity Theft Red Flags Rule,"[20] 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

[19] The SEC's action is available here.

[20] 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.

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.[21]

### 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. As noted above, FPIs usually comply with Regulation FD as a matter of best practice.

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[22] ("Version 1.1") to clarify and refine its original 2014 framework.[23] 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; I advances new standards for authentication and identity proofing 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.

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21 *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."

22 A fact sheet describing Version 1.1 is available here.

23 Available here.

## Part III: Disclosure Considerations and Regulatory Developments and Updates

### PCAOB Auditing Standard 3101[24] and Related Guidance

In October 2017, the SEC unanimously approved[25] 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")[26] 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.[27] [28]

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, including audit reports of FPIs, 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

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24 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."

25 Available here.

26 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.

27 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.

28 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."

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.

## 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 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.

### 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 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.[29] 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.[30] 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).

## Inline XBRL and Changes to Form 20-F Cover Page

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.[31] 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, including Form 20-F, to eliminate references to compliance with the website posting requirement.

The cover page of Form 20-F has been revised as follows:

> Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

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 were effective as of September 17, 2018.

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.

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

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

31 For more information, see our prior alert here.

## Disclosure Simplification (DUSTER)[32]

In August 2018, the SEC adopted amendments[33] 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.[34] The changes impacting FPIs include, among others:

- *Exchange Rate Data* – Eliminated the requirement[35] to disclose exchange rate data when financial statements are prepared in a currency other than US dollars, given that exchange rate data is now readily available on many free websites. This change affects Form 20-F as well as registration statements on Forms F-1 and F-4.

- *Age of Financial Statements* – Eliminated the requirement[36] to obtain a formal waiver from the SEC when an FPI conducting an initial public offering ("IPO") includes audited financial statements that are older than 15 months, rather than 12 months as would otherwise be required. Prior to the amendment, an FPI was required to obtain a waiver from the SEC by representing to the Staff that: (i) it is not public in any jurisdiction prior to the IPO; (ii) it is not required to comply with the requirement to provide audited financial statements that are not older than 12 months in any other jurisdiction outside the US and (iii) that complying with the requirement is impracticable or involves undue hardship. As the Staff virtually always granted the waiver requests, the requirement was deemed obsolete. FPIs must still comply with the 15-month age of financial statements requirement. The SEC also kept the requirement to make the necessary representations and to file them as an exhibit to the registration statement.

- *Selected Financial Data for FPIs Reporting for the First Time Under International Financial Reporting Standards ("IFRS")* – Amendments to Form 20-F[37]: (i) eliminated the requirement to present selected financial data in accordance with US GAAP; and (ii) explicitly state that for FPIs relying on the accommodation for the first-time application of IFRS[38] selected financial data is required only for the same two-year period for which the issuer presents financial statements prepared in accordance with IFRS. These changes are designed to simplify compliance efforts by eliminating the US GAAP requirement and aligning the selected financial data requirement with the accommodation provided for first-time IFRS adopters without the need for a formal request for accommodation.

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32 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.

33 The final rules can be found here. Other changes include: (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 the 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 a 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."

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

35 Item 3.A.3 of Form 20-F.

36 *See* Instruction 2 to Item 8.A.4 of Form 20-F.

37 General Instruction G(c) and Instruction 2 to Item 3.A of Form 20-F.

38 General Instruction G of Form 20-F.

- *Dividend Restrictions* – Eliminated requirements[39] to disclose in Form 20-F any dividend restrictions and any limitations on the payment of dividends, since (i) FPIs are already required to disclose dividend restrictions in the notes to the financial statements and (ii) Item 5.B.1(b) of Form 20-F requires disclosure of restrictions on a subsidiary's ability to transfer funds to its parent company, including in the form of dividends. The change also affects registration statements on Form F-1, which refer to the same disclosure requirements in Form 20-F.

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 20-F and the financial statements contained therein.

## Revisions to Form S-8

In July 2018, the SEC issued a concept release soliciting comments on ways to modernize its rules related to compensatory securities offerings[40] in light of various recent developments, such as the proliferation of the so-called "gig economy,"[41] by updating the requirements of Rule 701[42] and Securities Act Form S-8,[43] including by:

- 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.

## NYSE/Nasdaq Updates

### NYSE Dividend Notification Requirements

In August 2017, the SEC approved an amendment to the NYSE Listed Company Manual (the "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 hour's notification requirement went into effect on February 1, 2018.[44]

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39 *See* Items 10.F and 14.B of Form 20-F.

40 Securities issued for compensatory purposes to certain eligible recipients, including company employees, officers, directors, partners, trustees, consultants and advisors.

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

42 Rule 701 provides an exemption from registration for securities issued by non-reporting companies (which may include FPIs listed in their home jurisdiction) for compensatory purposes to certain eligible recipients.

43 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."

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

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

In September 2018, the SEC approved[45] 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**.**
>
> (ii) eliminates the requirement for shareholder approval of issuances at a price less than book value but greater than market value.[46]

Similarly, in October 2018, the NYSE proposed[47] 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:

- change the definition of market value for purposes of the shareholder approval rule; and
- eliminate the requirement for shareholder approval of issuances at a price less than book value but greater than market value.[48]

# Part IV: Future Rulemaking: Looking Ahead

## Concept Release Regarding Changes to Form S-8

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

## House Passes "Jobs Act 3.0"

In July 2018, the House passed the "Jobs and Investor Confidence Act of 2018."[49] Among other things, the bill would:

1. Require the SEC to analyze the costs and benefits of, and alternative formats for, quarterly reporting for EGCs.
2. 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.

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[45] Available here.

[46] 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.

[47] Available here.

[48] 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)).

[49] Available here.

3. Require companies with multi-class share structures to make certain proxy statement disclosures about shareholders' voting power.

4. Allow EGCs with less than US$50 million average annual gross revenue to opt out of auditor attestation requirements beyond the typical 5-year period.

5. Amend the definition of "accredited investor" to include people with education or job experience that would allow them to evaluate investments.

6. 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.

7. Allow venture exchanges for small and emerging companies to register with the SEC.

8. 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[50] 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.

## Dodd-Frank Compensation Clawback Rule[51]

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.[52] 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.

This discussion reflects the current state of pending Dodd-Frank-related disclosure requirements

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50 Available here.

51 The proposed rule can be found here.

52 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.

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