



SEC Rulemaking and Corporate Governance Developments

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Sean M. Donahue
Chair, Public Company Advisory Practice



Key Areas

SEC Rulemaking Developments

- Pay for Performance (adopted)
- Universal Proxy (adopted)
- Compensation Clawbacks (adopted)
- Rule 10b5-1 Plans (proposed)
- Cybersecurity (proposed)
- Climate Change (proposed)
- Schedule 13D/13G – Modernization of Beneficial Ownership Reporting (proposed)
- Human Capital (proposed)
- Board Diversity (proposed)

Evolving Board Diversity Expectations

Focus on ESG – Environmental/Social/Governance

Governance in a Time of Market Uncertainty

Selected Delaware Law Developments

SEC Enforcement Landscape

SEC Initiatives

June 2022 Regulatory Flex Agenda Announcement

- On June 22, 2022, the Chair of the SEC announced the agency's Unified Agenda of Regulatory and Deregulatory Actions . . . setting forth priorities for the balance of 2022 and into 2023.
- Noting that regulation cannot be static in a dynamic society, the Chair laid out a series of target dates for implementation of a broad set of rule proposals (these are discussed in the slides that follow):
 - Cybersecurity Risk Governance – Final rule expected April 2023
 - Climate Change Disclosure – Final rule expected 2023
 - Rule 10b5-1 & Insider Trading – Final rule expected April 2023
 - Schedule 13D/Schedule 13G – Modernization of Beneficial Ownership Reporting – Final rule expected April 2023
 - Human Capital Disclosure – Proposed rule expected 2022
 - Board Diversity Disclosure – Proposed rule expected April 2023

SEC Initiatives (cont.)

Pay for Performance

- Under Dodd Frank, the SEC was instructed to adopt rules requiring companies to disclose in proxy and information statements information showing the relationship between executive compensation actually paid and company financial performance.
- The SEC adopted the final rules in August 2022. The new rules first apply to companies with fiscal years ending on or after December 16, 2022.
- Key requirements:
 - A “pay versus performance” table disclosing the following information for each completed fiscal year required to be shown in the table:
 - (1) total compensation for the principal executive officer (PEO) and (2) average total compensation for the company’s other named executive officers (NEOs), showing both Summary Compensation Table total compensation and a new measure of compensation “actually paid”;
 - the cumulative total stockholder return of (1) the company and (2) a peer group from the beginning of the period shown in the table through the end of such year; and
 - company net income and a company selected financial performance measure.

SEC Initiatives (cont.)

Key requirements (continued):

- Based on the information provided in the table, the company needs to include a “clear description” of the relationship between (1) the compensation “actually paid” to the company’s PEO and the average compensation “actually paid” to the company’s other NEOs and (2) the financial performance measures included in the table as well as the company’s cumulative TSR for each year, including a comparison of the cumulative TSR of the company and its peer group.
- A company will also be required to provide a list of three to seven financial performance measures that the company determines are its most important measures (using the same approach as taken for the company selected financial performance measure). Companies are permitted, but not required, to include non-financial measures in the list if they consider such measures to be among their three to seven “most important” measures.
- If there are different measures used to determine the compensation of a NEO (e.g., a head of an operating unit with compensation largely based on unit-focused metrics), company should provide a list of the three to seven financial performance measures used to determine that NEO’s compensation.
- Companies will be required to use Inline XBRL to tag their pay versus performance disclosure.

SEC Initiatives (cont.)

Universal Proxy Rules

- Adopted by SEC in November 2021 (effective for meetings from September 2022).
- Each of the company's and dissident's proxy card in a contested director election will now be required to include all director nominees up for election, rather than only those of the company or dissident filing the proxy statement.
 - Makes it easier for shareholders to vote for a mix of management nominees and dissident nominees.
 - Previously, shareholders voting by proxy were effectively limited to a choice between voting for all of the company's director nominees or all of the dissident director nominees because they could only vote on the company's or the dissident's proxy card.
- New approach provides dissidents with a new way to access a company's proxy card in contested director elections and, unlike "proxy access" bylaws, without having to meet any share ownership requirement.
- If a company faces a contested election, the new universal proxy rules will require an array of new procedural and notice requirements.

SEC Initiatives (cont.)

Compensation Clawbacks

- Under Dodd Frank, the SEC is required to adopt rules to direct national securities exchanges (NYSE/Nasdaq) to prohibit the listing of securities of issuers that have not developed and implemented a policy providing for disclosure of the issuer's policy on incentive-based executive compensation and mandating the clawback of such compensation in certain circumstances – primarily an accounting restatement due to non-compliance with a financial reporting requirement.
- Final rule was issued in October 2022 and will go effective 60 days following publication in the Federal Register.
- Key Aspects:
 - Applies to all executive officers (whether they were involved in the matters giving rise to the restatement or not).
 - No fault requirement – applies to any material restatement (little “r” or big “R”).
 - Companies must disclose their clawback policies as an exhibit to the annual report filed with the SEC.

SEC Initiatives (cont.)

Compensation Clawbacks

- Key aspects (cont.):
 - Clawback policies would need to cover all incentive-based compensation – any compensation that is granted, earned or vested based wholly or in part upon the attainment of a financial reporting measure. These measures include those that are determined and presented in accordance with the accounting principles used in preparing the company's financial statements; any measures that are derived wholly or in part from those measures (e.g., EBITDA, FFO, return on assets or invested capital, financial ratios, liquidity, return and earnings measures, and sales per square foot or same store sales, among others); and stock price and TSR.
 - For compensation earned based on a company's stock price or total shareholder return (TSR), the clawback policy would need to require recovery of an executive's compensation based on "a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return upon which the incentive-based compensation was received."
 - Companies would be required to compute clawback amounts without regard to any taxes paid.
 - Companies would be required to clawback excess incentive-based compensation received by executive officers during the three fiscal years preceding the date on which the company is required to prepare the restatement.

SEC Initiatives (cont.)

Proposed Rule 10b5-1 Plan Changes

- Published for public comment by SEC in February 2022; SEC targeting April 2023 for implementation.
- What is a 10b5-1 Plan?
 - Recognizing that executive officers and directors frequently are restricted from trading in company stock due to having material nonpublic information (MNPI), the SEC established Rule 10b5-1 to provide an affirmative defense to an allegation of insider trading if the requirements of the rule are satisfied.
 - It is available to individuals and entities making purchases or sales of securities who can demonstrate that, *when not aware of any MNPI*, they entered into a binding plan to purchase or sell the security.
 - There already exist a number of rules on setting up qualifying plans as well as best practices designed to ensure that plans are entered into in good faith and not for the purposes of avoiding insider trading liability.

SEC Initiatives (cont.)

Proposed Rule 10b5-1 Plan Changes (cont.)

In response to concerns over perceived abusive practices relating to 10b5-1 plans, the SEC proposed new rules governing them. While some are consistent with existing best practices, other aspects are new:

- 120-day mandatory “cooling off” period following adoption or amendment of a plan before trading under the plan may begin or recommence
- Written certification to the issuer that the holder is not aware of any MNPI concerning the issuer and is adopting or amending the plan in good faith
- No overlapping plans
- Single-trade plans limited to one during any 12-month period
- Companies must make quarterly public disclosure of plan adoptions, amendments and terminations by directors and officers
- Section 16 reports would need to indicate whether a reported transaction was made pursuant to a Rule 10b5-1 plan or not

SEC Initiatives (cont.)

Proposed Rule 10b5-1 Plan Changes (cont.)

- Once the rules are adopted, companies will need to consider updating their insider trading policies to reflect the new landscape.
- Insider trading policies of public companies will be required to be published publicly.
- Companies will also want to implement new disclosure controls and procedures to ensure compliance with the likely new disclosure requirements and revised Section 16 rules.
- The rules will also apply to 10b5-1 plans entered into by the company itself in connection with share repurchase plans; additional rules apply in that context.

SEC Initiatives (cont.)

Cybersecurity

- The SEC has also proposed rule amendments to enhance issuer disclosures regarding cybersecurity risk governance. Published for public comment in March 2022; SEC targeting April 2023 for implementation.
- Rules center on:
 - Expanded Disclosure: specific prescribed disclosure topics and areas that cover cyber risks, cyber incidents, and board and management structures implemented by companies to manage and oversee cyber risks and incidents.
 - Accelerated Disclosure of Incidents: accelerated disclosure of cyber incidents by requiring companies to report material cyber incidents on Form 8-K within four business days after the company determines that the incident was material and requiring companies to make materiality determinations “as soon as reasonably practicable after discovery.” The proposed rules would require companies to update these disclosures in their Form 10-Q and Form 10-K reports.

SEC Initiatives (cont.)

Cybersecurity (cont.)

- Board Cybersecurity Expertise: proposed rules would require companies to identify any member of the board of directors who has expertise in cybersecurity matters and to disclose the qualifications and experience of any such director in cybersecurity matters. This is likely to increase competitive pressures on board recruitment.
- The proposed rules do not provide any disclosure exemptions or accommodations or any deferred compliance dates for companies that qualify as smaller reporting companies or emerging growth companies under SEC rules.

SEC Initiatives (cont.)

Climate Change

- The SEC has also proposed extensive rule amendments to enhance (enlarge) and standardize (make comparisons easier) disclosures regarding the impact of climate change on a company's business. Published for public comment in April 2022; SEC reopened comment period in October 2022; final rule expected in 2023.
- Central to the rules are prescribed disclosure on:
 - Impact of climate change and management of those risks, including impacts on strategy, business model and outlook;
 - Oversight and governance of climate-related risks by the company's board and management, including identification, assessment and management of risks and related governance matters;
 - How any climate-related risks identified by the company have had or are likely to have a material impact on its business and consolidated financial statements over the short-, medium-, or long-term;
 - Processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the company's overall risk management system or processes;

SEC Initiatives (cont.)

Climate Change (cont.)

- Any transition plans, scenario analysis and internal carbon pricing used by the company; and
- If the company publicly discloses climate-related targets or goals, information about how the company plans to meet the targets or goals and the time horizon for achievement of the targets or goals.
- Audited Financial Statements Disclosure:
 - New required footnote disclosure in audited financial statements about the impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a company's consolidated financial statements, as well as the financial estimates and assumptions used in the financial statements.
 - Very detailed presentation requirements would include disaggregation of positive and negative impacts and a requirement to break out individual financial statement line items, triggered at the 1% level (regardless of materiality standards).

SEC Initiatives (cont.)

Climate Change (cont.)

- The proposed rules would have a significant impact on company reporting systems, including internal control over financial reporting and disclosure controls and procedures. Significant increases in audit costs would also be expected.
- Disclosure and Expert Attestations of greenhouse gas (“GHG”) emissions based on a framework similar to the Task Force on Climate-Related Financial Disclosure:
 - *Scope 1 and Scope 2 disclosure*—all companies would be required to disclose Scope 1 and Scope 2 emissions (exclusive of any purchased or generated offsets) on both a disaggregated and aggregated basis for the fiscal years presented in the company’s financial statements, to the extent such data is reasonably available.
 - Attestation required for accelerated filers and large accelerated filers by independent expert, which in practical terms will likely mean Big Four audit firms.

SEC Initiatives (cont.)

Climate Change (cont.)

- *Scope 3 disclosure*—all companies, except smaller reporting companies, would be required to disclose Scope 3 emissions produced in the company's supply chain: (1) if material to the company or (2) whether or not material to the company, if the company has included Scope 3 emissions as part of a public GHG emissions reduction target or goal.
 - Attestation not required for Scope 3 disclosures.
 - Proposal includes a safe harbor where the company has a reasonable basis for the disclosures and makes the disclosures in good faith.
- Other than the exemption from the Scope 3 GHG disclosures for smaller reporting companies, the proposed rules do not provide any exemptions for companies that qualify as smaller reporting companies or emerging growth companies under SEC rules.

SEC Initiatives (cont.)

Climate Change (cont.)

- Litigation over the proposed rules is expected.
- The proposed rules would phase in disclosure requirements over three years, starting with the first full fiscal year following effectiveness.
 - If adopted during 2022, large accelerated filers would first include the new disclosures in their Form 10-K reports for the year ended December 31, 2023, to be filed in early 2024.
 - Accelerated filers and non-accelerated filers would become subject to the new disclosure requirements one year later.
 - Smaller reporting companies would become subject to the new disclosure requirements two years later.

SEC Initiatives (cont.)

Schedule 13D/13G – Modernization of Beneficial Ownership Reporting

- Section 13 of the Exchange Act and related SEC rules and regulations generally provide that an investor who “beneficially owns” more than 5% of a registered class of voting equity securities must publicly file either a Schedule 13D or a Schedule 13G disclosing such ownership.
- The SEC has proposed rule amendments that would modernize the filing deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G.
- The proposed amendments also would clarify and affirm the operation of the regulation as applied to when two or more persons are deemed to have formed a “group.”
- In addition, the proposed amendments would deem holders of certain cash-settled derivative securities as beneficial owners of the reference equity securities and clarify the disclosure requirements of Schedule 13D with respect to derivative securities.
- The proposed amendments were issued in February 2022 with final rules expected to be issued by April 2023.

SEC Initiatives (cont.)

13D/13G – Modernization of Beneficial Ownership Reporting (cont.)

- The proposed filing deadline changes apply to both initial Schedule 13D and Schedule 13G filings as well as amendments to them. Notable updates include:
 - Initial 13D filing due 5 days after passing 5% threshold (formerly 10 days).
 - Initial 13G filing for qualified institutional investors and exempt investors due 5 business days after end of the month if >5% (formerly 45 days after calendar year-end).
 - Initial 13G filing for passive investors due 5 days after passing 5% threshold (formerly 10 days).
 - For 13D amendments, filing is due 1 business day following any material change (formerly was “promptly”).
 - For 13G amendments, filing is due 5 business days after month-end following any material change (formerly 45 calendar days after year-end).

SEC Initiatives (cont.)

13D/13G – Modernization of Beneficial Ownership Reporting (cont.)

- To address increasingly complex financial instruments, the SEC also proposes to deem a holder of certain types of cash-settled equity derivatives as the “beneficial owner” of the underlying reference equity securities if such person holds the derivative with the purpose or effect of changing or influencing the control of the issuer of such class of equity securities or in connection with or as a participant in any transaction having such purpose or effect.
 - Excludes cash-settled security-based swaps on the basis that such derivative securities are subject to ongoing rulemaking.
- The SEC also proposes to amend rules for determining when a “group” exists for Section 13 purposes as follows: under the proposed rules, the determination as to whether two or more persons are acting as a group will not depend solely on the presence of an oral or written express or implied agreement; rather, depending on the particular facts and circumstances, concerted actions by two or more persons for the purpose of acquiring, holding or disposing of securities of an issuer – even in the absence of any agreement – will be considered sufficient to constitute the formation of a group.
 - The proposed rule does provide new exemptions to permit persons to communicate and consult with each other, jointly engage issuers and execute certain transactions without being subject to regulation as a group.

SEC Initiatives (cont.)

Human Capital Disclosure

- In recent 10-K annual reports, companies began including required disclosure to describe human capital resources and objectives or measures used in the management of the business that are material to the understanding of their business.
- The SEC indicated that this was to be “principles-based” disclosure.
- In other words, the disclosure requirements were not prescriptive in terms of topics to be discussed or metrics to be used; we saw a range of approaches.
- The SEC has indicated that it is now developing a potential new rule that would require public companies to disclose more specific data such as workforce diversity, part-time versus full-time workers and employee turnover.
- The SEC is targeting release of a proposed rule in 2023.

SEC Initiatives (cont.)

Board Diversity

- The SEC announced in the Spring of 2022 that it is considering rule amendments to enhance mandatory disclosures about the diversity of board members and nominees.
- The SEC is targeting publishing proposed rules for comment in April 2023.
- These rules would be distinct from the Nasdaq diversity matrix disclosure requirement that was approved by the SEC and became effective for Nasdaq companies in August 2021.
- It is unclear what would be the specifics of the proposed rules.

Evolving Board Diversity Expectations for Public Companies

Board diversity is an area of intense interest across the SEC, state governments, the exchanges, large institutional stockholders and proxy advisory firms. Some key things to know:

- With some transition period, all Nasdaq-listed companies will be required to have, or explain why they do not have, one diverse director and disclose the gender/racial/ethnic makeup of the board.
- Unclear if or when NYSE will adopt a similar requirement.
- As noted above, SEC is likely to propose rules on board diversity – likely to be disclosure-related.

Large institutional investors, including Blackrock, State Street, Vanguard, and Fidelity are very focused on board diversity as are proxy advisory firms ISS and Glass Lewis.

ESG Matters

“ESG” refers to how a company addresses environmental, social and governance matters as it operates its business.

Environmental

- What impact does the company have on the environment? What is its environmental footprint (e.g., e-waste programs, other recycling initiatives)?

Social

- What impact does the company have on its stakeholders and society generally? Considerations include culture of diversity and inclusion; focus on employee health and well-being; product safety; responsible business practices; and community involvement.

Governance

- How is the company run? Considerations include maintaining a diverse, well-qualified and majority independent board; commitment to ethics with a strong tone at the top (published code of ethics); and commitment to privacy best practices.

ESG Matters (cont.)

Why does addressing ESG issues matter?

- Investors. Large institutional investors, such as BlackRock, State Street, Vanguard, and Fidelity are increasingly vocal about their ESG expectations of companies.
- Employees. Key retention and recruiting issue – employees increasingly make decisions about their jobs based on whether employers share their views on key matters such as the environment and social issues.
- Partners. Increasingly, business partners are closely scrutinizing their relationships to ensure that their partners share their view on ESG issues.
- Reputation. Perceptions of how a company addresses ESG matters can have a direct impact on its reputation in the media, across its customer base and in the community.

ESG Matters (cont.)

Companies do not necessarily need to launch full scale ESG departments or initiatives, but they can work on:

Messaging

- Articulate and publish a corporate mission and purpose that goes beyond profit making; how is your company making customers' lives/businesses better?
- Reinforce on internal websites and in employee messaging that the company is committed to employee engagement and that senior management takes ethical conduct seriously.

Environmental Matters

- Understand the environmental impact of the company's operations: medical waste, plastic usage.
- Understand the practices of the company's supply chain.

ESG Matters (cont.)

Social Issues

- Ensure the board includes diversity (gender and racial/ethnic) as factors it considers in establishing its membership; carry through on that by having a diverse board (and senior management roster).
- Tout the company's involvement in the community.

Governance

- Create and publish a code of ethics on the website and include messaging from the CEO reinforcing its importance and management's commitment to it.
- Set aside time on the agendas for the board to discuss management of ESG issues.

Governance in a Time of Market Uncertainty

With stock markets suffering significant declines in 2022, alongside rising inflation, continuing supply chain issues and the war in Ukraine, boards of directors are operating in an unsettled climate.

Adherence to best practices in terms of process and meeting directors' duties of care and loyalty are paramount, particularly when considering the following types of matters:

- Option repricing
- Share repurchasing
- Developing plans to avoid de-listing
- Alternative financing transactions such as PIPEs, At-the-Market offerings, Registered Direct offerings
- Workforce reductions
- Stock drop issues (shareholder litigation, FINRA investigations)
- Strategic alternatives (sale transactions, going private)
- Investor relations, including dealing with activist investors

Selected Delaware Law Developments – DGCL Amendments

With a majority of public companies chartered in Delaware, developments in the corporation law of that state can have significant corporate governance impact.

Notable updates to the Delaware General Corporation Law that took effect August 1, 2022, include:

- enable corporations to include in their certificates of incorporation provisions limiting the liability of identified executive officers for breaches of their duty of care in suits brought directly against them by stockholders
- authorize boards of directors to delegate to a person or body the power to issue stock (not just stock options or rights to acquire stock) subject to required parameters set forth in the board resolution approving delegation
- empower beneficial owners of a company's stock to make appraisal demands in their own name rather than requiring them to cause the holder of record to demand appraisal on their behalf
- eliminate the requirement to make a list of stockholders available during a meeting of stockholders, including a meeting conducted solely by remote communication
- update provisions relating to notice of stockholders' meetings to add procedures governing the adjournment of virtual meetings in circumstances where a technical failure has occurred

Selected Delaware Law Developments – Case Law Developments

- Board Oversight
 - So-called Caremark claims have been more likely to survive a motion to dismiss – reminding directors of their obligation to establish monitoring and reporting systems and to appropriately respond to red flags of corporate misconduct or malfeasance.
 - Important for boards to monitor key regulatory issues and document in board and committee minutes that it has established effective reporting and compliance systems and that it has responded appropriately to any red flags.
- D&O Insurance Where Fraud Found
 - Delaware Supreme Court held it does not violate Delaware public policy for D&O insurance to cover losses arising from fraudulent conduct.

Selected Delaware Law Developments – Case Law Developments

- Good Faith Reliance by Board on Advisors
 - In several cases, Delaware courts reiterated that DGCL Section 141(e) provides directors with protection in the board's exercise of its oversight and other responsibility when they rely in good faith on the advice and information provided by corporate officers in the board's exercise of its oversight and other responsibilities.
- Conflicts of Interests
 - Delaware courts continue to look closely at different ways companies manage conflicts of interest, scrutinizing the structure and actual effectiveness of different approaches: abstentions, special committees, and approvals by disinterested shareholders and independent directors.

Selected Delaware Law Developments – Case Law Developments

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Current SEC Enforcement Division Priorities

- We expect to see a continued focus on the following areas – Common Theme is “Robust Enforcement”
 - All things Crypto – both issuers and associated platforms
 - Cybersecurity
 - ESG
 - Disclosure and Financial/Accounting Misconduct
 - Gatekeeper and individual accountability (including accountants and lawyers)
 - Books and Records, including Off Channel Communications
 - Private Funds/Private Equity
 - Whistleblower Protections compliance matters
 - Incentivizing Cooperation and Remediation

“Robust Enforcement” = Significant Remedies

- The Commission and SEC staff are committed to using all of the arrows in its quiver to hold violators accountable.
- This will likely be reflected not just in the charges, but in the remedies sought/imposed.
- Important remedies to note are:
 - Disgorgement of ill-gotten gains and PJI – leave nothing “on the table”
 - Often involves complex calculations and negotiations; particularly regarding “legitimate” expenses
 - Clawback of incentive and other bonus compensation and stock sale profits (SOX 304)
 - Officer and Director Bars (more expansive use)
 - Industry Bars (even for non-scienter based charges)
 - Ordered undertakings (regulated entities and otherwise)
 - Conduct-Based Injunctions (prohibiting otherwise legal conduct)

Thank You