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GLOBAL PUBLIC COMPANY ACADEMY

US DISCLOSURE AND REPORTING UPDATES

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Agenda

- Refresher on Modernization of Regulation S-K Items 301, 302, and 303 and Lessons Learned from Early Adopters
- Impact of Nasdaq's Board Diversity Rules
- SEC's Continued Focus on Cybersecurity
- Themes from SEC's Climate-Related Disclosure Form Comments

MODERNIZATION OF REGULATION S-K ITEMS 301, 302, AND 303

Modernization to MD&A and Financial Disclosure Requirements

- On November 19, 2020, the SEC issued a final rule (Release No. 33-10750) regarding the elimination of Regulation S-K Item 301 (Selected Financial Data) and modifications to Item 302 (Supplementary Financial Information) and Item 303 (MD&A).
- The final rule was adopted to eliminate duplicative disclosures and enhance MD&A disclosures for the benefit of investors, while simplifying compliance efforts for registrants.
- The final rule went effective on February 10, 2021, and must be applied in a registrant's 10-K filed in respect of a year ending on or after August 9, 2021.

Elimination of Item 301 of Regulation S-K

- Item 301 of Regulation S-K required a registrant to provide five years of selected financial information in tabular format. The original reason for the requirement was to supply the information in one place to highlight significant trends in the registrant's historical financial condition.
- Item 301 of Regulation S-K was eliminated because the information required to be provided by Item 301 is now easily accessible through EDGAR and other online resources.

Modification of Item 302 of Regulation S-K

- **Old:** Item 302(a) of Regulation S-K required registrants to disclose selected quarterly financial data and to discuss any variances between the data presented and those previously reported on a Form 10-Q filing.
- **New:** While registrants are no longer required to disclose selected quarterly financial information for the eight preceding quarters, if a registrant reports a material retrospective change that pertains to the financial statements for any of the eight preceding quarters, a registrant must:
  - provide an explanation of the reasons for the material change(s); and
  - disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information and earnings per share reflecting such changes.
- Although the SEC proposed to eliminate Item 302(b) (supplementary financial information related to oil, and gas-producing activities) due to an overlap with proposed amendments to US GAAP reporting requirements, Item 302(b) remained unchanged, as the proposed US GAAP amendments had not yet been finalized.

Amendments to Item 303 of Regulation S-K

- Item 303 of Regulation S-K contains the requirements for Management's Discussion and Analysis of Financial Condition and Results of Operations, commonly referred to as MD&A.
- The SEC adopted multiple changes to both annual and quarterly MD&A disclosures, including focusing on a more principles-based approach similar to the recently approved revisions to the Business description and codifying SEC guidance since the last rewrite of this Item.
- These changes include:
  - A new subsection explicitly stating the SEC's purposes behind the MD&A disclosures;
  - An updated explanation of the requirements for discussion of period-to-period changes and the underlying reasons behind them;
  - Requiring discussion of material cash requirements among other "capital resources" disclosures;
  - Replacing the "off-balance sheet arrangement" disclosure requirement with an instruction to the rules advising companies to disclose such arrangements in the broader context of results;
  - The elimination of the contractual obligations table; and
  - Permitting companies to choose to compare current quarter results to either the prior year period or the preceding quarter.

Lessons Learned from Early Adopters and Material Considerations

- The adopting release provided that registrants could comply with the amendments after February 10, 2021, so long as the registrant provided disclosure responsive to the particular amendment in its entirety (you cannot pick and choose).
- Many registrants took advantage of the elimination of the selected financial data required by Item 301 some, but fewer, registrants chose to voluntarily comply with the modifications to Items 302, and very few registrants chose to voluntarily comply with the modifications to Item 303.

SEC RELEASE NO. 33-10786

IMPACT OF NASDAQ'S BOARD DIVERSITY RULES

Background

- On August 6, the SEC approved Nasdaq's proposed board diversity and disclosure rules, which were originally submitted to the SEC for consideration on December 1, 2020.
- **Requirements**:
  - disclose statistical information on board diversity using a standardized board diversity matrix (Diversity Disclosure Rules); and
  - have at least two directors who are diverse, or, alternatively, explain why such requirement has not been met (Minimum Diversity Rules).
- **Affected Registrants**:
  - Each listed company (subject to certain exceptions for non operating companies), including smaller reporting companies and foreign private issuers.

Applicable Compliance Dates

- **Diversity Disclosure Rules**
  - Become effective on the later of (i) August 8, 2022 or (ii) the date on which the company files its proxy statement or information statement for its annual shareholders meeting during calendar year 2022.
- **Minimum Diversity Rule**
  - rules provide for a phase-in period based on a registrant's listing
  - August 7, 2023 – must have at least one diverse director
  - August 6, 2026 – must have at least two diverse directors

Next Steps

- Registrants should be updating annual D&O questionnaires to confirm that they will have all the information required to populate the board diversity matrix.
- Begin both the formal and informal recruitment process immediately; there are material consequences for failing to comply with the new rules, including a delisting, and registrants should put themselves in the best position to identify and retain the most qualified diverse director candidates.
- Registrants that have not provided board diversity disclosure in the past should begin to think about how such information will be disclosed in their 2022 proxy statement.
- Registrants that have provided board diversity disclosure in the past should confirm that such disclosure is responsive to the new rules.

SEC'S CONTINUED FOCUS ON CYBERSECURITY DISCLOSURE

Background

- On February 21, 2018, the SEC adopted a statement and interpretive guidance on cybersecurity disclosures.
- Guidance highlighted the need for a registrant to include cybersecurity disclosures within its periodic reports, expanded upon the materiality standard for cybersecurity risks, discussed timing of cybersecurity incident disclosure, and identified factors to be considered when disclosing cybersecurity risk, including, among others:
  - Occurrence of prior cybersecurity incidents;
  - Probability of future occurrences and their consequences;
  - Adequacy of preventative actions taken to reduce cybersecurity risks and the associated costs;
  - Aspects of the registrant's business and operations that give rise to material cybersecurity risks, and the potential costs and consequences of such risks;
  - Potential or reputational harm;
  - Existing or pending laws and regulations that may affect the requirements to which registrants are subject relating to cybersecurity, and the associated costs; and
  - Litigation, regulatory investigation, and remediation costs associated with cybersecurity incidents.
- In January 2020 the SEC's Office of Compliance Inspections and Examinations (now Division of Examinations) published additional guidance and observations.

Recent Enforcement Actions (First American Title Insurance)

- In June 2021, First American agreed to a cease-and-desist order to pay approximately $500,000 for disclosure controls and procedures violations related to a cybersecurity vulnerability that exposed sensitive customer information.
- According to the SEC's order, First American's web application contained a vulnerability that exposed more than 800 million images dating to 2003 (including bank account numbers, Social Security numbers, driver's license images, etc.).
- First American was made aware of the vulnerability by a cybersecurity reporter who published an article titled "First American Financial Corp Leaked Hundreds of Millions of Title Insurance Records". . . YIKES!
- First American issued a statement for inclusion in the report ("First American has learned of a design defect in an application that made possible unauthorized access to customer data. . . we are currently evaluating what effect, if any, this had on the security of customer information."). The next trading day First American filed an 8-K announcing the vulnerability.
- Less senior individuals within First American's information security department had known about the vulnerability as early as January 2019 and failed to remedy the problem and effectively communicate the issues to senior management. First American's CISO and CIO learned about the problem (and an internal report related thereto) over the weekend, but before the filing of the 8-K.

Recent Enforcement Actions (Pearson)

- In August 2021, Pearson plc agreed to pay $1 million to settle charges that it misled investors about a 2018 cyber intrusion involving the theft of millions of student records, including dates of births and email addresses, and had inadequate disclosure controls and procedures.
- According to the SEC's order, in March 2019 Pearson learned that millions of rows of data from its web-based software were hacked using an unpatched vulnerability. According to the SEC's order, a patch for the vulnerability was available and Pearson was aware of such but did not implement it.
- Pearson's management determined that the breach was not material and decided it was not necessary to issue a public statement regarding the breach (although in May 2019 Pearson prepared a reactive media statement, which it planned to issue in the event of a media inquiry about the incident).
- In July 2019 Pearson furnished its half-year report on Form 6-K, which included a data-security risk factor that referred to a data privacy incident as a hypothetical risk, when, in fact, the 2018 cyberintrusion had already occurred.
- Later in July 2019, in response to a media inquiry, Pearson issued its preprepared media statement related to the incident, which, according to the SEC's order, was misleading.
- The SEC's order found that Pearson violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20, 13a-15(a), and 13a-16 thereunder.

Lessons Learned From Recent Enforcement Actions

- Internal policies and procedures must be established to ensure that cybersecurity risks and breaches are appropriately communicated to the registrant's disclosure committee in a timely manner.
- Even when proper internal policies and procedures are established, a registrant must ensure that personnel in its information technology and information security departments appreciate the significance of timely disclosure.
- Registrants should consider providing cybersecurity training and information about the crossroads between cybersecurity breaches and public disclosure requirements.
- Registrants should be sure that they are making a sound and defensible materiality analysis. In Pearson, the SEC determined that the data breach was in fact material, notwithstanding management's analysis, because of its business and its user base and the nature and volume of the data exfiltrated.
- The SEC is likely to propose new cybersecurity risk governance rules by the end of 2021.

CLIMATE-RELATED DISCLOSURES

Background

- In 2010, the SEC issued interpretive guidance on disclosures related to climate change.
- Disclosure matters discussed in the 2010 climate change guidance included the following:
  - the impact of pending or existing climate change, related legislation, regulations, and international accords;
  - the indirect consequences of regulation on business trends; and
  - the physical impacts of climate change.
- In September 2021, the SEC published a sample comment letter setting forth comments the SEC may make to registrants regarding their climate-related disclosure (or lack thereof).
- In a lead in to the sample comment letter, the SEC reiterated that a number of disclosure rules may require disclosure related to climate change, including in the following parts of the 10-K.
  - Item 1, Business (material impacts of climate change)
  - Item 1A, Risk Factors (material risks faced as a result of climate change)
  - Item 3, Legal Proceedings (the impact of material pending legal proceedings related to climate change)
  - Item 7, MD&A (material impacts of climate change on a company's financial condition)

Sample Comments

General

1. We note that you provided more expansive disclosure in your corporate social responsibility report (CSR report) than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report.

Risk Factors

2. Disclose the material effects of transition risks related to climate change that may affect your business, financial condition, and results of operations, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, or technological changes.

3. Disclose any material litigation risks related to climate change and explain the potential impact to the company.

Sample Comments

Management's Discussion and Analysis of Financial Condition and Results of Operations

4. There have been significant developments in federal and state legislation and regulation and international accords regarding climate change that you have not discussed in your filing. Please revise your disclosure to identify material pending or existing climate change related legislation, regulations, and international accords and describe any material effect on your business, financial condition, and results of operations.

5. Revise your disclosure to identify any material past and/or future capital expenditures for climate-related projects. If material, please quantify these expenditures.

6. To the extent material, discuss the indirect consequences of climate-related regulation on business trends, such as the following:
   - decreased demand for goods or services that produce significant greenhouse gas emissions or are related to carbon-based energy sources;
   - increased demand for goods that result in lower emissions than competing products;
   - increased competition to develop innovative new products that result in lower emissions;
   - increased demand for generation and transmission of energy from alternative energy sources; and
   - any anticipated reputational risks resulting from operations or products that produce material greenhouse gas emissions.

Sample Comments

7. If material, discuss the physical effects of climate change on your operations and results. This disclosure may include the following:
   - severity of weather, such as floods, hurricanes, sea levels, arability of farmland, extreme fires, and water availability and quality;
   - quantification of material weather-related damages to your property or operations;
   - potential for indirect weather-related impacts that have affected or may affect your major customers or suppliers;
   - decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
   - any weather-related impacts on the cost or availability of insurance.
8. Quantify any material increased compliance costs related to climate change.
9. If material, provide disclosure about your purchase or sale of carbon credits or offsets and any material effects on your business, financial condition, and results of operations.

Climate Change Disclosure – Looking Ahead

- What should registrants be doing now?
  - Companies should determine to what extent climate change has affected (or may affect) their business and financial condition and performance
  - Review current disclosure to determine if such affects are adequately disclosed in light of the SEC's 2010 interpretive guidance
  - Review corporate social responsibility or other reports to make sure any climate-change disclosures are consistent with those set forth in SEC filings
- A proposal for mandatory climate change disclosure is expected to be released by the end of 2021 and the SEC's chair recently outlined rulemaking considerations that included, among others:
  - Location of disclosure (possibly Form 10-K);
  - Types of qualitative and quantitative disclosures;
  - Industry-specific disclosures; and
  - Jurisdictional requirements

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QUESTIONS?

Biography

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Bryan also regularly counsels public companies in annual, quarterly, and periodic reports; proxy statements and SEC compliance under US federal securities laws; and corporate governance requirements of various stock exchanges, including NYSE and Nasdaq.

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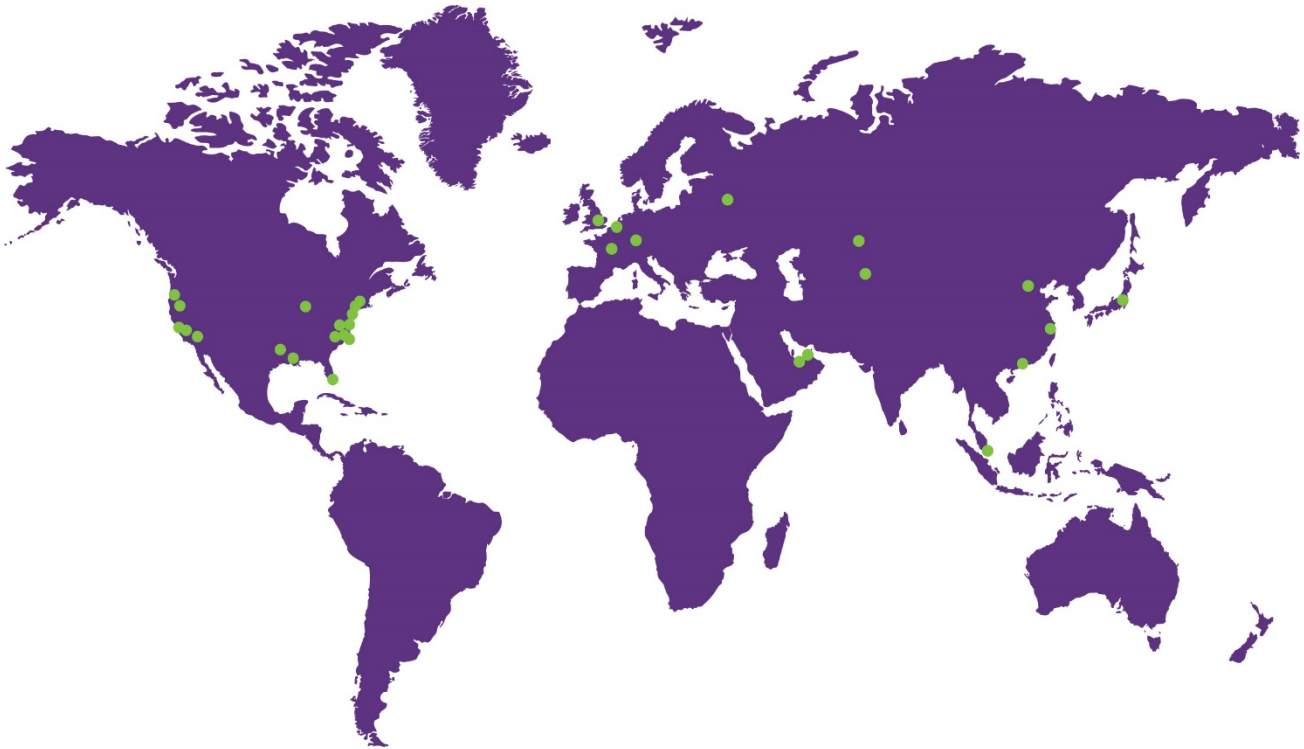

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