

COVID-19: SEC Filings and Disclosures for Public Companies and Annual Shareholder Meeting Logistics

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Agenda

- Risk factor and forward-looking information disclosures
- Other annual report disclosure considerations
- Electronic signatures on SEC filings
- Impact on the proxy statement
- Lessons from SEC enforcement actions
- Virtual annual shareholder meeting logistics

Disclosure in Form 10-K

- Disclosure of the actual and potential impacts of COVID-19 may be appropriate or necessary based on the SEC's principles-based disclosure requirements in connection with a registrant's preparation of its Form 10-K. Areas to consider include:
 - Risk factors
 - Business
 - Legal proceedings
 - Management's discussion and analysis
 - Disclosure controls and procedures
 - Internal control over financial reporting
 - Financial statements

Guidance from the SEC Staff

- The SEC staff has issued guidance related to COVID-19 disclosures in various forms:
 - CF Disclosure Topic No. 9 – March 2020
 - Joint Statement regarding earnings releases – April 2020
 - CF Disclosure Topic No. 9A – June 2020
 - Statements from SEC’s Chief Accountant – April and June 2020
 - Comment letters issued to registrants

Amendments to Regulation S-K Item 105

- Summary required if the Risk Factors section exceeds 15 pages
 - 2 pages or less
 - In the “forepart” of the annual report or prospectus
- Standard changed from “most significant” to “material” risks
- Organize logically under relevant headings
 - Subcaption describing the risk still required
- Generic risk factors are discouraged and, if presented, must be placed at the end under the caption “General Risk Factors”

Risk factors

- At the beginning of the pandemic, many companies addressed their risk factor disclosures by including a generic pandemic-related risk. As time has passed, the expectation is that an issuer will update specific, tailored risks

Sample SEC comment

We note your disclosure that the extent to which your operations may be impacted by the COVID-19 pandemic will depend largely on future developments, which are highly uncertain and cannot be accurately predicted, including new information that may emerge concerning the severity of the outbreak and actions by government authorities to contain the outbreak or treat its impact. Please amend your risk-factor disclosure to provide more detailed risks related to the COVID-19 pandemic, tailored to your specific facts and circumstances. For guidance, see CF Disclosure Guidance: Topic No. 9 (25 March 2020)

- Review existing risk factors, and consider whether these should be revised to address events that already have come to pass, and to address new risks that have been identified as the pandemic has become more prolonged and its effects more wide-reaching
- Consider the impact of COVID-19 as it relates to all risks

Forward-looking disclosure

- Chairman Clayton and Director Hinman's joint statement urged companies to provide as much information as is practicable regarding their current financial and operational status, as well as their future operational and financial planning
- "We...recognize that companies often are cautioned to limit their forward-looking disclosures, and particularly specific estimates, to those required by our rules to limit legal risk in the event the forward-looking estimates prove to be incorrect. In this regard, we encourage companies to avail themselves of the safe-harbors for forward-looking statements." See Section 27A of the Securities Act and Section 21E of the Exchange Act
- Historical information may be relatively less significant
- Would not expect good faith attempts to provide appropriately framed forward-looking statements to be second-guessed by the SEC

- SEC Staff guidance has been particularly detailed regarding expectations for disclosure in the MD&A section that is specific to the issuer, the effects of the pandemic on the issuer's actual results of operations, the effects on liquidity (*including modifications to its debt obligations, recent financing transactions, access to credit lines, going concern issues*), and the need to provide investors with insight regarding trends and expectations for future performance

Sample SEC comment

We noted that, given the uncertainty of the impacts of COVID-19, you are monitoring your ability to comply with debt covenants in future periods and are in discussions with certain counterparties to your debt obligations. In future filings, please expand your disclosures to include the significant debt covenants and the particular subsidiaries affected.

SEC Staff comments on COVID-19 disclosure in MD&A

- Future trends and uncertainties, impacts
 - Failure to disclose

Sample SEC comments

On your first quarter earnings call, you indicate that you currently anticipate second quarter revenue to be down as much as 50% to 60% with approximately 80% of your global business having been closed since April 1, 2020. Revise your future periodic filings to disclose known trends and uncertainties related to COVID-19. For example, disclose how you expect COVID-19 to impact your future operating results and near-and-long-term financial condition and how that compares to the current period. See Item 303 of Regulation S-K, SEC Release No. 33-8350, and CF Disclosure Guidance Topic No. 9.

We note your disclosure regarding the . . . grounding and your recognition of a . . . liability for potential concessions and other considerations to customers for disruptions related to the grounding. In future filings, please provide enhanced disclosures to better clarify the nature and amounts of the various concessions you are providing. It appears your concessions may be in the form of cash, in-kind consideration and other forms of concessions. Please consider providing a tabular presentation of the concessions by type, so that investors can better understand the expected impacts to your cash flows and operating results.

Amendments to Regulation S-K Item 101

Description of Business

- Expands principles-based approach
- Registrants, in filings made after their initial filing, may provide an update of the general development of the business rather than a full discussion
- New human capital resources disclosure topic
 - The company's human capital resources (e.g., number of employees), and
 - Human capital measures or objectives that the company focuses on in managing its business.
- Government regulations – not just environmental anymore
- Other disclosure items – any topic regarding the company's business that is material to an understanding of the business; no quantitative thresholds.

Description of business

- While issuers may now have more flexibility with respect to the presentation in the Business section, given the pandemic's effect on the issuer's business, its workforce, actual or potential changes in its business model or policies regarding work from home, changes in demand for its products or services, and similar matters, this year, it may make sense to present a more detailed (*rather than a summary*) discussion

Human capital resources

- Consider whether human capital management disclosure related to COVID-19 is required by the new disclosure topic in Regulation S-K
- “Beyond the income statement and the balance sheet effects, we recognize that COVID-19 may significantly impact operations, including as a result of company efforts to protect worker health and well-being and customer safety. The impact of company actions and policies in this area may be of material interest to investors, and we encourage disclosures that address that interest.”

Non-GAAP adjustments

- CF Disclosure Topic No. 9 provides reminders and guidance related to the presentation of non-GAAP financial measures and reconciliation
 - Item 10 of Regulation S-K
 - Regulation G
 - Commission Guidance on Management’s Discussion and Analysis of Financial Condition and Results of Operations (Jan. 30, 2020)
- Reconciliation guidance applies to earnings releases
- “[I]n filings where GAAP financial statements are required, such as filings on Form 10-K or 10-Q, companies should reconcile to GAAP results and not include provisional amounts or a range of estimated results.”

Non-GAAP adjustments *(cont'd)*

- Originally, may have been presented as a one-time adjustment:
 - PPE, cleaning supplies, dividers, retrofitting
 - Lease termination costs
 - Supply chain disruptions
 - Workforce issues such as severance or bonuses for working onsite
- As the pandemic lasts, consider if treating COVID-19 adjustments as temporary may imply ongoing costs are lower

Electronic signatures on SEC filings

- Amendments to Regulation S-T
- The signature page to an SEC filing (the “authentication document”) can be signed manually **or electronically**
 - Must still retain this authentication document for five years
- But first, the signatory must **manually** sign a document agreeing that an electronic signature constitutes the legal equivalent of the signatory’s manual signature for any filing with electronic signature
 - Must retain this electronic signature authentication document for at least seven years after the date of the most recent electronically signed authentication document

Electronic signatures on SEC filings

- Signing process for electronic signature must:
 - Require the signatory to present a physical, logical, or digital credential that authenticates the signatory's individual identity
 - Reasonably provide for non-repudiation of the signature
 - Provide that the signature be attached, affixed, or otherwise logically associated with the signature page or document being signed
 - Include a timestamp to record the date and time of the signature

Impact on the proxy statement

- Letters to shareholders
 - An opportunity (*but not a requirement*) for company management to address, among other things:
 - The effects of COVID-19 on the company, its business, its workforce
 - The company's responses to COVID-19 in areas such as workforce management, safety, business adjustments, business continuity
 - Check for consistency of tone and message with the proxy and other disclosures
 - Present an accurate, balanced view

Impact on the proxy statement

- Compensation disclosures
 - Changes to named executive officer (NEO) compensation
 - Has the NEO agreed to forgo salary, bonus or perquisites?
 - Have any of these amounts been adjusted? Or has compensation been paid in stock?
 - Has the company repriced options?
 - Has the company changed the metrics used to evaluate performance, eligibility for bonuses, or other aspects of compensation?
 - Revising the CD&A section this year may require close consideration of historical and expected financial performance

Impact on the proxy statement

- Compensation disclosures (*cont'd*)
 - The SEC published new C&DI 219.05
 - Must continue to apply SEC's long-standing perquisite test
 - Enhanced technology needed to make the NEO's home his or her primary workplace due to local stay-at-home orders is **not** a perquisite because it is integrally and directly related to the performance of the executive's duties under perquisite test
 - But, new COVID-19-related health and transportation benefits **may be** perquisites unless they are generally available to all employees
 - There may not be the same outcome from a tax perspective

Impact on the proxy statement

- How will ISS assess COVID-related pay decisions?
 - Compensation Policies FAQs (12-21-20)
 - U.S. Compensation Policies and the COVID-19 Pandemic FAQs (10-15-20)
 - ISS qualitative evaluation **will** take into consideration the impact on company operations as a result of the pandemic
 - Disclosure considerations
 - Changes to bonus/annual incentive programs
 - Lowering of financial or operating targets
 - Go-forward changes to equity/long-term incentive cycles beginning in 2020
 - Retention or other one-time awards

Impact on the proxy statement

- Glass Lewis Approach to Executive Compensation in the Context of the COVID-19 Pandemic
 - Glass Lewis has not changed its approach to executive pay; a pragmatic, contextual approach that applies in good and bad times
 - Pay-for-performance alignment
 - Describe how pay aligns with the company's performance, on a relative and absolute basis
 - If there is misalignment in relative and absolute performance, disclose the board's consideration in balancing these levels

Impact on the proxy statement

- Glass Lewis Approach to Executive Compensation in the Context of the COVID-19 Pandemic (*cont'd*)
 - Say-on-pay proposals
 - Lowering executive base salaries – meaningful adjustment or token gesture?
 - Significant increases to target or actual payouts?
 - Mid-cycle adjustments to performance awards or their replacement with time-based awards?
 - One-off awards – thorough disclosure of structure, necessity and appropriateness to align pay with company performance is expected

Impact on the proxy statement

- Glass Lewis Approach to Executive Compensation in the Context of the COVID-19 Pandemic (*cont'd*)
 - Companies with a history of strong governance, pay-for-performance, and appropriate use of board discretion prior to the pandemic have more leeway
 - Equity plan proposals
 - Provide clear, **sufficient justification** for large share requests that result in significant dilution, which could include:
 - An urgent need to conserve cash
 - Exhaustion of reasonable alternatives to compensate employees

Impact on the proxy statement

- Corporate governance disclosures
 - Board oversight of risk during the pandemic:
 - How has the board discharged its oversight role?
 - Additional meetings?
 - Consideration of reductions in force, closures or similar measures
 - Consideration of workplace safety and human capital measures
 - Has the board or has the audit committee undertaken additional measures with respect to cybersecurity oversight?
 - Succession planning

Impact on the proxy statement

- Corporate governance disclosures (*cont'd*)
 - Audit committee/Audit committee reports
 - Consider the statements made by the Chief Accountant, as well as the PCAOB's conversations with audit committee chairs
 - How has the audit committee responded to:
 - Complexities of company staff and audit teams working from home?
 - Changes to audit procedures or to the company's accounting policies?
 - Challenges relating to the company's control environment?
 - Has the committee vetted non-GAAP COVID-19 adjustments? Impairments? Changes to estimates or to policies requiring judgment?

Impact on the proxy statement

- CEO Pay Ratio
 - Generally required to identify the median employee only once every three years
 - 2020 disclosure (based on 2019 compensation) was the third year of pay ratio disclosure
 - If the median employee has been re-used since the 2018 disclosure, must be re-identified for the 2021 disclosure
 - Where median employee is no longer employed, may substitute another employee
 - Must have substantially similar compensation as the previous median employee, using the same consistently applied compensation measure as was previously used

Impact on the proxy statement

- CEO Pay Ratio (*cont'd*)
 - The company must re-identify the median employee for a fiscal year where the company reasonably believes there would be a significant change to its pay ratio disclosure because of a change in the company's:
 - Employee population or
 - Employee compensation arrangements
 - Do any COVID-related changes require re-identifying the median employee?

Impact on the proxy statement

- Virtual Annual Meeting
 - Proxy disclosure of process to attend, participate, vote, technical support
- Proposals to Amend Charter Documents to Permit Virtual Meetings
 - Glass Lewis expects companies to commit in the proposal or in the supporting documents, at a minimum, to:
 - Disclose the procedures and requirements to participate in a virtual meeting at the time of convocation, and
 - Disclose that there will be a formal process in place for shareholders to submit questions to the board, which will be answered in a format that is accessible to all shareholders
 - If the virtual format will be used only in exceptional circumstances, include a commitment to disclose the exceptional circumstances for the virtual meeting at the time of convocation

Lessons from SEC enforcement actions

- Cheesecake Factory (Dec. 4, 2020) – First enforcement action for misleading investors about the financial effects of the pandemic
 - Statements the company was “operating sustainably” when it was losing \$6M per week and had only 16 weeks of cash remaining and had informed its landlords that it would not pay any rent in April, due to impacts of the pandemic
 - Shared its financial distress with potential private equity investors but gave the opposite message to the market
 - SEC: When public companies describe the impact of COVID-19, they must be accurate. Disclosure should be tailored to the firm and industry-specific effects of the pandemic on the business and operations. Issuers who make materially false or misleading statements will be held accountable
 - Echoes the March 23, 2020 Statement from the Co-Directors of the Division of Enforcement

Lessons from SEC enforcement actions

- Decision Diagnostics Corp. (Dec. 18, 2020) – Enforcement action against the company and the CEO following temporary trading suspension in April 2020
 - Making false and misleading claims in press releases regarding the development of a working, break-through COVID-19 rapid blood test when, at the time, they had no physical testing device and their technology was unproven
 - SEC: This is an unprecedented time when the need for truthful disclosures concerning COVID-19 tests is very important. The Commission is identifying potential areas of fraud during the pandemic to hold accountable those who exploit the pandemic to harm investors

Virtual annual shareholder meeting logistics

- SEC Guidance for Holding Virtual Annual Meetings
 - Ability to hold a VSM is governed by state law
 - Robust disclosures that facilitate informed shareholder voting are just as important for a virtual meeting as they are for an in-person meeting
 - When holding a virtual meeting, the Staff expects the issuer to:
 - Notify its shareholders, intermediaries in the proxy process, and other market participants of such plans in a timely manner
 - Disclose in the definitive proxy statement and soliciting materials clear logistical directions for how shareholders can remotely access, participate in, and vote at the meeting
 - The Staff also encouraged registrants to provide shareholder proponents with the ability to present their proposals at the shareholder meeting through means other than an in-person appearance (such as by telephone)

Virtual annual shareholder meeting logistics

- State Law – Executive Orders and Accommodations
 - Illinois, Missouri – Virtual-only meetings are not expressly permitted; remote participation is permitted when authorized by the board
 - Massachusetts – Permitted for public companies until 60 days after the MA state of emergency ends
 - New Jersey – Permitted during the state of emergency, which has been extended
 - New York – Permitted by statute due to COVID-19, in effect until December 31, 2021

Virtual annual shareholder meeting logistics

- The investor perspective
 - **Negative Views** – Many continue to be opposed to virtual shareholder meetings and find them inadequate as a replacement for in-person meetings due to:
 - Lack of Q&A transparency
 - Limited ability to ask follow-up questions
 - Lack of in-person experience
 - **Positive Views** – Some shareholders view the VSM as favorable for the ability it affords to attend, present proposals and ask questions at many more meetings
 - **Shareholder Proponent Views** – Proponents generally had no trouble presenting their proposals, and many companies gave them a choice in how to present proposals

Virtual annual shareholder meeting logistics

- Multi-stakeholder principles and best practices for holding virtual shareholder meetings:
 - Disclosure – Instructions on how shareholders can attend and participate; instructions on how to submit questions; reasons for using a virtual-only format (due to COVID-19, and in the future)
 - Preparation – Company training and rehearsals; communication with shareholder proponents; allowing shareholders to test internet connectivity
 - VSM Platform – Audio or video format; voting; questions; posted content
 - Assistance for attendees
 - Proceedings of the Meeting – Announcements; shareholder proposals; Q&A session; post-meeting

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