

Legal Update

10 Tips for 10-Ks and Proxy Statements

With the 2020 proxy and annual reporting season upon us, here are 10 tips for companies to consider when drafting annual reports on Form 10-K and proxy statements for filing with the US Securities and Exchange Commission (SEC).

Form 10-K Tips

1. Risk Factors. As companies review risk factor disclosures for their annual reports on Form 10-K, there are a number of key areas that may be particularly relevant to update.

Intellectual Property and Technology. In December 2019, the SEC's Division of Corporation Finance issued disclosure guidance that companies should consider in connection with intellectual property and technology risks associated with international business operations. Companies that do business in, and with companies from, non-US jurisdictions should evaluate whether they need to add or expand their risk factor disclosure in light of the issues raised by this recent guidance. For more information, see our Legal Update "Ring in the New Year with SEC Year-End Guidance," dated January 7, 2020.¹

Brexit. Companies that may be significantly affected by Brexit need to be sure their Brexit disclosure, including Brexit risk factor

disclosure, is updated to include recent developments and their potential impact.

LIBOR. The SEC staff has signaled that it will be actively monitoring the extent to which the risks expected as a result of the discontinuation of LIBOR are being identified and addressed. Therefore, it is important for companies to consider whether they need to add, update or elaborate on their LIBOR disclosure in risk factors and management's discussion and analysis (MD&A).

Cybersecurity. Cybersecurity is generally recognized as a major global risk. Cybersecurity risk factor disclosure should be specifically tailored to a company's unique facts and circumstances. If a company's cybersecurity has previously been materially compromised, disclosure limited to hypothetical risks may not be sufficient to satisfy a company's reporting obligations.

Other Issues. Among other current topics that companies may want to evaluate from a risk factor disclosure perspective are the impact of tariffs and sanctions, immigration policies, potential terrorism and armed conflicts.

2. Amendments to Form 10-K Disclosure Requirements. In March 2019, the SEC adopted amendments intended to modernize and simplify certain disclosure requirements of Regulation S-K. Key elements of these

amendments applicable to annual reports on Form 10-K are summarized below. For additional information, see our Legal Update “SEC Adopts Rules to Modernize and Simplify Disclosure,” dated March 27, 2019,² and our Legal Update “Follow-Up on Regulation S-K Modernization and Simplification,” dated April 3, 2019.³

MD&A. As a result of the amendments, the MD&A instructions now provide that a company may use any presentation that, in its judgment, enhances a reader’s understanding of the company’s financial condition, and changes in financial condition and results of operations, as opposed to specifying year-to-year comparisons. As amended, the discussion of the earliest year is not required in MD&A if financial statements included in the filing cover three years and the discussion was already included in the company’s prior filings on the SEC’s EDGAR system, as long as the company identifies the location in the prior filings where the omitted discussion may be found. In addition, the MD&A requirements no longer specify that five-year selected financial data need to be discussed when trend information is important, although trend information is required for a number of parts of MD&A, including liquidity and capital resources and results of operations.

Property. Disclosure of principal physical properties is now based on materiality to the company and may be provided on a collective basis, if appropriate. The amendments did not modify instructions to Item 102 of Regulation S-K that are specific to the oil and gas industry.

Exhibits. The amendments permit omission of confidential information from material contracts filed as exhibits without submitting a confidential treatment request to the SEC if such information is both not material and would likely cause competitive harm if disclosed (although companies may use confidential treatment request procedures if

they wish). In addition, the amendments permit the redaction of immaterial provisions or terms in agreements relating to acquisitions, reorganizations, arrangements, liquidations or successions that would likely cause competitive harm if publicly disclosed. The amendments also allow the omission of schedules and similar attachments to exhibits unless they contain material information that is not otherwise disclosed in the exhibit or the disclosure document.

Additional Hyperlinks. Companies must provide hyperlinks to information that is incorporated by reference if that information is available on EDGAR at the time the form is filed, whether or not the information is in a document filed as an exhibit.

3. Critical Audit Matters. The audit report for large accelerated filers will need to disclose any critical audit matter (CAM) or state that the auditor determined that there were no CAMs. Any matter arising from the audit of financial statements that was communicated or required to be communicated to the audit committee will be a CAM if it both:

- relates to accounts or disclosures that are material to the financial statements, and
- involves an especially challenging, subjective or complex auditor judgment.

Determination of whether an accounting issue is a CAM involves a principles-based analysis.

4. New Registered Securities Description Exhibit. Companies must now prepare an additional exhibit to their annual reports on Form 10-K describing each class of securities that is registered under Section 12 of the Securities Exchange Act of 1934 based on the disclosure requirements of Item 202(a) through (d) and (f) of Regulation S-K. Because this is a new requirement, it is worthwhile to begin preparing this exhibit well in advance of the Form 10-K filing date. While descriptions of securities from prior SEC filings can provide

a useful starting place for this new exhibit, companies will need to assess whether updates are needed, for example, to reflect changes to governance documents.

Proxy Statement Tips

5. Hedging Disclosure. The 2020 proxy season will be the first proxy season in which most public companies will be required to disclose whether employees (including officers) or directors or their designees are permitted to purchase financial instruments or otherwise engage in transactions that hedge or offset, or that are designed to hedge or offset, any decrease in the market value of a company's equity securities granted to the employee or director as compensation or held directly or indirectly by the employee or director. The hedging disclosure rule only requires disclosure of practices and policies. It does not require disclosure of any hedging transactions that have occurred, although other existing disclosure requirements may reveal that company equity securities have been hedged by an executive officer. As companies prepare their hedging policy disclosure, they may also find it worthwhile to evaluate whether they would like to amend any current hedging policy, or adopt a new hedging policy, prior to filing their proxy statements.

6. Pay Ratio: Median Employee Determination. The pay ratio rule, which requires disclosure of the ratio of the annual total compensation of a company's median employee to that of its chief executive officer, permits a company to identify its median employee only once every three years as long as the company reasonably believes there has not been a change in its employee population or compensation arrangements that would significantly change the pay ratio disclosure. Since this is the third year of the mandatory pay ratio disclosure, many companies might be eligible to use a previously identified

median employee if they so choose. In any event, companies must disclose the date used to identify the median employee.

7. Shareholder Proposal Changes. New for the 2020 proxy season, the SEC staff will no longer automatically provide a formal no-action letter in response to requests regarding the exclusion of shareholder proposals. When responding to a no-action request to exclude a shareholder proposal, the staff will continue to inform the proponent and the company of its position, but the response may be that the staff concurs, disagrees or declines to state a view with respect to the company's asserted basis for exclusion. The staff has posted a chart on the SEC's website indicating whether or not the staff concurred with an exclusion and whether the staff issued a letter in response. If a company does not receive a formal no-action letter, it will need to decide whether it is comfortable excluding a shareholder proposal from its proxy statement and whether such approach could impact voting for directors, particularly as a result of recommendations from proxy advisory firms.

The SEC has proposed amendments to Rule 14a-8—the rule that governs shareholder proposals—which, among other things, would change the ownership and resubmission thresholds for submitting a shareholder proposal for inclusion in a company's proxy statement. The proposed amendments are still in the comment period stage as of the date of this Legal Update. Therefore, it is not expected that any final amendments will impact the 2020 proxy season, but this remains an area to watch for future developments.

8. Proxy Voting Advice Guidance and Proposals. In August 2019, the SEC issued guidance regarding proxy voting advice provided by advisory firms, such as Shareholder Services Inc. (ISS) and Glass Lewis. One key point from this guidance is that proxy voting advice provided by a proxy advisory firm constitutes a solicitation under current

proxy rules. The guidance also made clear that antifraud provisions apply to such solicitations by those firms, even if there is an exemption from the proxy solicitation rules that proxy advisory firms may rely on. ISS sued the SEC, asserting that this guidance is unlawful and seeking declaratory and injunctive relief, but, as of the date of this Legal Update, that guidance is in effect and is therefore applicable to the 2020 proxy season.

In November 2019, the SEC proposed amendments to the proxy solicitation rules that would add conditions to the exemptions that proxy advisory firms typically rely on, requiring them to:

- specifically disclose material conflicts of interest in their proxy voting advice, and
- give each company an opportunity to review and provide feedback on proxy voting advice before it is issued as long as the company files its definitive proxy statement at least 25 days before the meeting with respect to the shareholder vote.

As of the date of this Legal Update, the comment period for this proposal remains open and the proposal contemplates a one-year transition period after the effective date of the final rules. Therefore, it will take a while before any such amendments could be expected to take effect.

Voluntary Disclosures

9. Voluntary Disclosures. Voluntary disclosures, by their very nature, could be contained in various places, such as an annual report on Form 10-K, a proxy statement or a dedicated report appearing on a company's website or in material otherwise disseminated by a company.

ESG Disclosure. With growing interest in environmental, social and governance (ESG) issues among certain investors, some

companies have chosen to discuss sustainability initiatives in distinct sections of their proxy statements. Enhanced ESG disclosures, including in documents filed with the SEC, such as proxy statements, may be well-received by institutional investors, proxy advisory firms and organizations that rate public company corporate governance. This approach may provide an opportunity for companies to control their ESG message and may provide a basis to guide shareholder engagement in this area.

Companies voluntarily adding ESG disclosure in SEC filings should coordinate such disclosure with statements on their websites and other public statements to ensure consistency. Such disclosure needs to be carefully drafted. For example, aspirational efforts for ESG should not be presented as formal commitments by the company. Because ESG disclosure is multi-faceted and, in some cases, quite specialized, it may make sense to involve personnel who do not otherwise assist with the proxy process in the drafting and review of the disclosure. Companies considering ESG proxy statement or annual report sections may need additional lead time to develop this disclosure.

Human Capital Disclosure. The SEC has proposed amendments to Regulation S-K that, if adopted, would require human capital disclosure as part of a company's business description. This description would include any human capital measures or objectives that management focuses on in managing the business, such as measures or objectives that address the attraction, development and retention of personnel. While this proposal has not yet been finalized, some companies have already begun to voluntarily provide public human capital disclosure.

Technical Changes

10. Captions, Cover Page and Exhibit Index.

The proxy statement caption for reporting late filings of Forms 3, 4 or 5 has been changed to read "Delinquent Section 16(a) Reports." The Form 10-K cover page no longer requires a checkbox for late Section 16 filings.

The cover page of the Form 10-K must include the trading symbols for each class of the company's listed securities.

If companies disclose their executive officer biographies in Part I of Form 10-K (as opposed to including them in the proxy statement), the caption has been changed to "Information about our Executive Officers."

Companies that are using Inline XBRL need to reference new exhibit 104 in the Form 10-K exhibit index with respect to cover page items that are now required to be tagged.

Additional Information

For additional information about preparing annual reports and proxy statements this year, see our Legal Update "2020 Proxy and Annual Reporting Season: Time to Get Ready—Already," dated September 24, 2019.⁴

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Endnotes

¹ Available at <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/01/sec-year-end-guidance.pdf>.

² Available at <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/03/skmodernizationadopted.pdf>.

³ Available at <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/04/legal-update-follow-up-on-sk-modernization-and-simplification.pdf>.

⁴ Available at <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/09/2020proxyandannualreportseasontimetogetryalready.pdf>.

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