Thursday, January 11 at 2:00 pm

GIBSON DUNN 2024 CA MCLE BLITZ

SEC RULEMAKING AND RELATED DEVELOPMENTS

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SEC Developments Related to Annual Report on Form 10-K

01

Status of Share Repurchase Disclosure Rules

On December 19, 2023, the Fifth Circuit vacated the SEC's new share repurchase disclosure rules, holding that the SEC acted arbitrarily and capriciously, in violation of the Administrative Procedure Act.

As a result, the pre-existing share repurchase disclosure rules, requiring information on share repurchase programs and quarterly repurchase disclosures presented on an aggregated, monthly basis, remain in effect.

The new rules would have applied to the upcoming Form 10-K for calendar year filers and would have required the company to:

1. disclose **daily repurchase data in a new table filed as an exhibit** to Form 10-Q and Form 10-K;
2. indicate by a **checkbox** whether any **executives or directors traded** in the company's equity securities **within four business days** before or after the **public announcement of a repurchase plan or program** or the announcement of an increase of an existing share repurchase plan or program;
3. provide **narrative disclosure** about the company's repurchase program, including its objectives and rationales, in the filing; and
4. provide quarterly disclosure regarding the **company's adoption or termination of any Rule 10b5-1 trading arrangements, per new Reg. S-K Item 408(d)**.

For further details, see our client alert available here.

Cybersecurity Incident Reporting Requirement

- Retained 8-K Requirement (new Item 1.05)
  - Reporting material cybersecurity incidents within four business days
    - Trigger is date of materiality determination; requirement to make materiality determination “without unreasonable delay after discovery of the incident” – replaced proposed standard (as soon as reasonably practicable)
  - Narrowed the required disclosures to include:
    - Material aspects of the nature, scope, and timing of the incident; and
    - Material impact or reasonably likely material impact on the company, including its financial condition and results of operation;
  - For any required information that has not been determined or is unavailable at the time of the required filing, must update the disclosure through a Form 8-K/A (not a 10-Q) within four business days after company, without unreasonable delay, determines the information or after it becomes available
  - Notes qualitative factors to determine materiality
  - Narrow exceptions for delaying filing
  - Untimely filing would not result in loss of S-3 eligibility
  - Disclosure would be covered by FLS safe-harbor rules

Cybersecurity Form 10-K Disclosure of Risk Management and Strategy

- **Risk Management and Strategy***:* Companies must describe their processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats in sufficient detail for a reasonable investor to understand those processes. Disclosure should address, as applicable:
  - whether and how any such processes have been integrated into the company's overall risk management system or processes;
  - whether the company engages assessors, consultants, auditors, or other third parties in connection with such processes; and
  - whether the company has processes to oversee and identify such risks from cybersecurity threats associated with its use of any third-party service provider.
- Companies must also describe whether any risks from cybersecurity threats, including as a result of any previous cybersecurity incidents, have materially affected or are reasonably likely to materially affect the company, including its business strategy, results of operations, or financial condition and if so, how.
  - "*Cybersecurity Threat*" is defined as any potential unauthorized occurrence on or conducted through a company's information systems that may result in adverse effects on the confidentiality, integrity, or availability of a company's information systems or any information residing therein.

Cybersecurity Form 10-K Disclosure of Governance

Companies must describe the board's **oversight of risks from cybersecurity threats**, including, if applicable, the board committee or subcommittee responsible for such oversight and the process by which the board or relevant committee is informed about such risks.

- Companies must also describe **management's role in assessing and managing material risks from cybersecurity threats**, as well as its role in implementing cybersecurity policies, procedures, and strategies. Disclosure should address, as applicable:
    - whether and which management positions or committees are responsible for assessing and managing such risks, and the relevant expertise of such persons or members in such detail as necessary to fully describe the nature of the expertise;
    - the processes by which such persons or committees are informed about and monitor the prevention, detection, mitigation, and remediation of cybersecurity incidents; and
    - whether such persons or committees report information about such risks to the board of directors or a committee or subcommittee of the board of directors.
- With respect to **management's expertise**, the instructions to Item 106 provide that it may include "[p]rior work experience in cybersecurity; any relevant degrees or certifications; any knowledge, skills, or other background in cybersecurity."

For further details, see our client alert available here.

Cybersecurity Changes from Proposed Rules

Incident Reporting

The timeline for the materiality determination – which must be made "without unreasonable delay" – reflects a change from the rule proposal, which required the determination to be made "as soon as reasonably practicable" after discovery of an incident.

The SEC's rule proposal would have required disclosure of the specific details of the incident, such as remediation status, whether the incident was ongoing, and whether data were compromised, regardless of materiality. The final rule narrowed the required disclosures to include:

- Material aspects of the nature, scope, and timing of the incident; and
- Material impact or reasonably likely material impact on the company, including its financial condition and results of operation.

The SEC introduced two narrow exceptions that allow for a delay in reporting a material cybersecurity incident on Form 8-K. The only generally applicable exception permitting a delay in reporting applies only if the U.S. Attorney General notifies the SEC in writing that the disclosure poses a substantial risk to national security or public safety.

Form 10-K Disclosure of Risk Management and Strategy

Notably, the final rule requires disclosure of "processes" rather than "policies and procedures," with the SEC noting that the former avoids disclosing operational details that could be used by malicious actors and removes the question of whether companies without written policies and procedures should disclose that fact.

Other changes aimed at reducing the prescriptiveness of the rule include:

- the removal of the list of risk types (e.g., intellectual property theft, fraud, etc.), and
- the removal of certain disclosure items, such as:
  - the company's activities undertaken to prevent, detect, and minimize effects of cybersecurity incidents, and
  - the company's business continuity, contingency, and recovery plans in the event of a cybersecurity incident.

Form 10-K Disclosure of Governance

Exclusions from the final rule include:

- the proposed requirement to disclose whether and how the board integrates cybersecurity into its business strategy, risk management, and financial oversight; and
- details such as whether the company has a chief information security officer, the frequency of the board's discussions on cybersecurity, and the frequency with which responsible management positions or committees report to the board on cybersecurity risk.

Rule 10b5-1 Plan Amendments Changes to Conditions of Safe Harbor

On December 14, 2022, the SEC adopted a final rule introducing substantive changes to the safe harbor for trading arrangements under Rule 10b5-1

The rule changes amend the Rule 10b5-1(c)(1) affirmative defense to insider trading liability to include:

- A cooling-off period for directors and officers of the later of: (1) 90 days following plan adoption or modification; or (2) two business days following the disclosure in certain periodic reports of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification) before any trading can commence under the trading arrangement;
- A cooling-off period of 30 days for persons other than issuers or directors and officers before any trading can commence under the trading arrangement or modification;
- A condition for directors and officers to include a representation in their Rule 10b5-1 plan certifying, at the time of the adoption of a new or modified plan, that: (1) they are not aware of material nonpublic information about the issuer or its securities; and (2) they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5;
- A limitation on the ability of anyone other than issuers to use multiple overlapping Rule 10b5-1 plans;
- A limitation on the ability of anyone other than issuers to rely on the affirmative defense for a single-trade plan to one such plan during any consecutive 12-month period; and
- A condition that all persons entering into a Rule 10b5-1 plan must act in good faith with respect to that plan.

For further details, see our prior post available here.

Rule 10b5-1 Plan Amendments Quarterly Disclosure of Trading Arrangements

In Forms 10-Q and 10-K, companies are required to disclose whether, during the company's last fiscal quarter, any director or officer **adopted or terminated (which includes certain modifications)** a Rule 10b5-1 plan or a "non-Rule 10b5-1 trading arrangement."

A **"non-Rule 10b5-1 trading arrangement"** is a written trading arrangement that complies with the old Rule 10b5-1 affirmative defense but does not comply with the new affirmative defense conditions.

For both types of plans, companies will also need to provide a description of the material terms, other than with respect to price, including:

- The name and title of the director or officer;
- The date of adoption or termination;
- The duration; and
- The aggregate number of securities to be sold or purchased.

The information must be reported using **XBRL tagging**.

For further details, see our prior post available here.

Comment Letter Trends

MD&A

- focused on disclosures relating to results of operations, requesting more specificity
- focused on disclosures regarding material period-to-period changes in quantitative and qualitative terms as prescribed by Item 303(b) of Regulation S-K
- requested that registrants make disclosures about known trends and uncertainties affecting their results of operations
- ensured that key performance indicators are properly contextualized so that they are not misleading
- asked registrants to quantify and provide additional disclosure regarding significant components of financial condition and results of operations that have affected segment results
- focused on critical accounting estimates and liquidity and capital resources

Non-GAAP Financial Measures

- aligned with the Compliance and Disclosure Interpretations released last December
  - focus on whether operating expenses are "normal" or "recurring" (and therefore, whether exclusion from non-GAAP financial measures might be misleading)
  - whether certain non-GAAP adjustments to revenue or expenses have made the adjustments "individually tailored"
- compliance with Item 10(e) of Regulation S-K
  - prominence of non-GAAP measures, reconciliations, usefulness and purpose of particular measures
  - exclusion of normal, recurring cash operating expenses
  - use of individually tailored accounting principles

Segment Reporting

- whether a registrant's operating segments are properly categorized
- reasoning behind the aggregation of similar segments (and the factors used to identify different segments)

Note: the SEC has taken issue with registrants disclosing multiple measures of segment profit or loss in the notes to the financial statements and has indicated that registrants should not attempt to circumvent non-GAAP requirements when taking this approach.

Climate Change

Final SEC rules on climate-related disclosure are still pending, but the SEC has continued to issue Form 10-K comment letters regarding companies' climate-related disclosures under existing requirements.

Disclosure Trends
Climate Change

Items to consider in light of Staff comments made since the issuance of the SEC's sample comment letter related to climate change disclosure that it issued in 2021:

1. Tailor climate-related disclosures to the company's business and financial condition, rather than generic discussions on climate change.
2. Consider whether certain climate-related matters should be disclosed not only qualitatively, but also quantitatively.
3. For any climate-related disclosure included in the Form 10-K, take steps to adequately substantiate those disclosures.
4. As part of the disclosure controls and procedures for the 2023 Form 10-K filing, review the company's publicly disclosed ESG materials, such as the company's sustainability report, to determine whether any of the information is or may become material under federal securities laws.

Disclosure Trends
Human Capital

Principles-based requirement adopted in 2020:

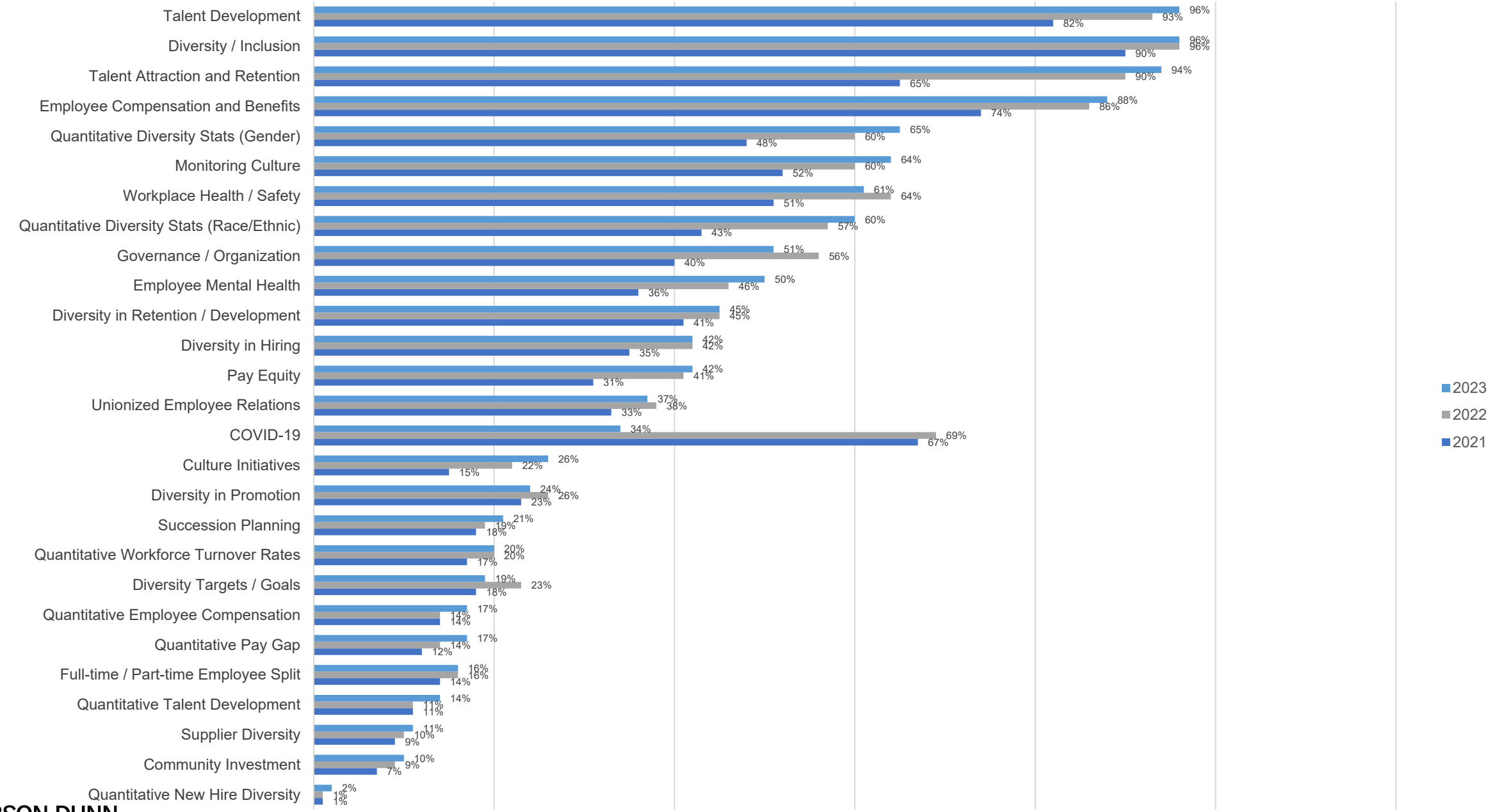
- Description of human capital resources
- Measures or objectives for managing the business
  - E.g., development, attraction, and retention of personnel

SEC Investor Advisory Committee recommendations for expanded disclosures:

- ***Headcount Metrics.*** Disclose "[t]he number of people employed by the issuer, broken down by whether those people are full-time, part-time, or contingent workers."
- ***Turnover Metrics.*** Disclose "turnover or comparable workforce stability metrics."
- ***Components of Compensation.*** Disclosure of "[t]he total cost of the issuer's workforce, broken down into major components of compensation."
- ***Demographic Data.*** Companies would also be required to disclose "[w]orkforce demographic data sufficient to allow investors to understand the company's efforts to access and develop new sources of talent, and to evaluate the effectiveness of these efforts."
- ***MD&A Disclosure.*** Disclose how the company's "labor practices, compensation incentives, and staffing" fit within the broader firm strategy.

For further details, see our client alert available here.

Evolution of S&P 100 Companies' Human Capital Disclosures



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Other Trends

Other disclosure trends to consider include:

- **Generative artificial intelligence**
  - E.g., effects on strategy, productivity, market competition and demand for products, investments, reputation, legal and regulatory risks
- **Geopolitical conflict**
  - E.g., Middle East, Russia/Ukraine, China/Taiwan, China/U.S.
- **Potential government shutdown**
  - E.g., Risk Factors, MD&A discussion of material losses
- **Inflation concerns**
  - SEC comment letters have focused on how current inflationary pressures have materially impacted a company's operations, mitigation efforts, and quantification of principal factors contributing to inflationary pressures
- **Interest rate concerns**
  - SEC comment letters have focused discussion of rising interest rates in Risk Factors and MD&A to identify actual impacts on the business

Other Considerations Disclosure Controls and Procedures

SolarWinds (Cybersecurity)

Complaint alleges that SolarWinds made a number of false statements relating to:

1. compliance with the National Institute of Standards and Technology (NIST) Cybersecurity Framework;
2. using a secure development lifecycle when creating software for customers;
3. having strong password protection; and
4. maintaining good access controls.

Activision Blizzard (Workplace Misconduct)

SEC alleged the company "lacked controls and procedures designed to ensure that information related to employee complaints of workplace misconduct would be communicated to [company] disclosure personnel to allow for timely assessment on its disclosures."

DXC Technology (Non-GAAP Financial Measures)

SEC alleged that the company materially increased its non-GAAP earnings by negligently misclassifying tens of millions of dollars of expenses as transaction, separation and integration-related ("TSI") costs and improperly excluding these expenses as non-GAAP adjustments.

Charter Communications Inc. (Internal Accounting Controls)

SEC alleged failure to establish internal accounting controls to provide reasonable assurances that its trading plans were conducted in accordance with the board of directors' authorization, which required the use of trading plans in conformity with Rule 10b5-1.

Other Considerations Characterization of Legal Proceedings

Reconsider relying on characterization of legal proceedings as "without merit" in legal proceedings disclosures after *City of Fort Lauderdale Police and Firefighters' Retirement System v. Pegasystems Inc.*

- Company was ordered to pay over $2 billion in damages in a prior lawsuit regarding trade secret misappropriation.
- 10-K disclosure stated:
  - "the claims brought against the defendants are without merit"
  - company had "strong defenses to these claims"
  - "any alleged damages claimed by [the plaintiff] are not supported by the necessary legal standard"
- Stock price dropped by ~16% after 10-K filed.
- In subsequent class action, court found that "a reasonable investor could justifiably have understood [the CEO]'s message that [the trade secret] claims were 'without merit' as a denial of the facts underlying [the] claims—as opposed to a mere statement that Pega[systems] had legal defenses against those claims."
- Appropriate alternatives: "we intend to contest this matter vigorously" or "we have substantial defenses" (if supportable).

Other Considerations Updates for 2023 Form 10-K

Compensation Clawback Disclosures

- Two new checkboxes on cover page to indicate whether (i) the financial statements included in the filing reflect a correction of an error to previously issued financial statements and (ii) any such corrections are restatements that required a recovery analysis.
- Companies must file their clawback policy as Exhibit 97 to the Form 10-K.

EDGAR Next

- Public beta environment is open until March 15, 2024.

Glossy Annual Reports

- Required to furnish annual reports electronically on EDGAR in PDF format no later than the day first sent or given to shareholders.
- Should not be re-formatted, re-sized, or otherwise redesigned for purposes of the submission on EDGAR.

Cover Page XBRL Disclosures

- Confirm presenting outstanding share data consistently throughout Form 10-K.

SEC Developments Related to Proxy Statement

02

Officer Exculpation

Slow and Steady Wins the Race

In August 2022, Section 102(b)(7) of the DGCL was amended to allow limiting monetary liability for certain officers for breaching the duty of care

- Similar (but not identical) in scope to existing director exculpation protections
- Must be implemented via an **amendment to the company's certificate of incorporation** (requires shareholder vote)

Public company adoption was **hampered by uncertainty** as to proxy advisory firm / institutional investor responses

- **ISS** will **support** exculpation amendments on a case-by-case basis
- **Glass Lewis** will generally **recommend against** proposals absent a "compelling" rationale
- Most proposals received **strong investor support**

During the 2023 proxy season, over 200 **Russell 3000** companies sought shareholder approval for exculpation amendments

- If a proposal failed, it was typically due to either:
  - A supermajority standard for charter amendments, and/or
  - Insufficient shareholder participation at the meeting

During the 2023 proxy season, only 26 **S&P 500** companies sought shareholder approval for exculpation amendments

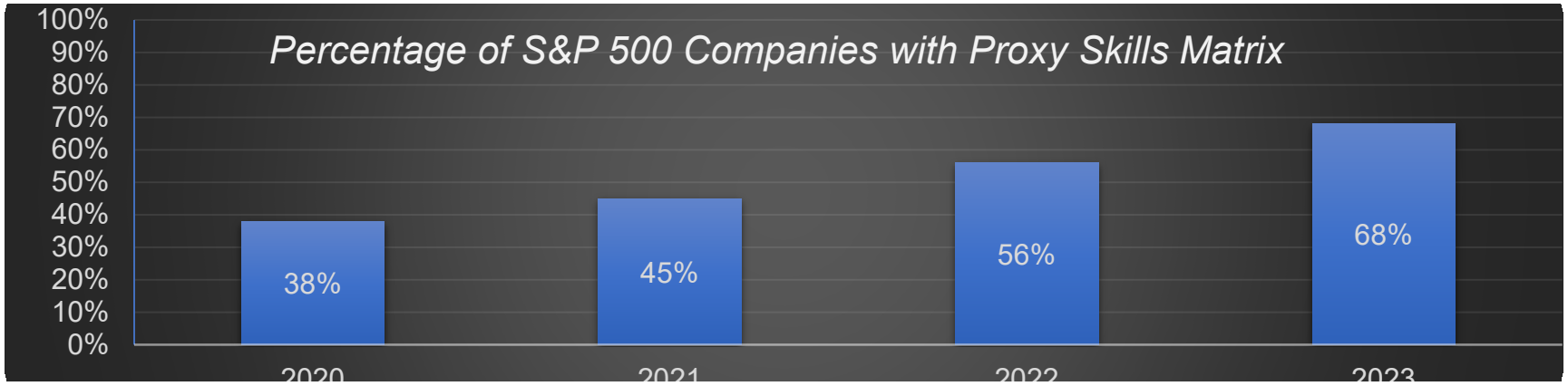
- Approximately 96% (all but one*) of **S&P 500** proposals were approved
- All received at least 60+% support

**Due to failure to meet supermajority vote requirement*

Director Bios & Skills Matrix*

Review and Refresh

- **Scrutiny of board members** continues to rise
- Median support for director nominees at **R3K** companies continues to decline year over year, dropping **500 bps** over the last two years to **97.3% in 2023**
- Blue-chip company directors continue to face **"vote no" campaigns**
- Universal proxy rules facilitate **targeting individual directors** with proxy contests
- Companies should **continue to enhance proxy disclosures** focused on **clearly articulating** what each director brings to the board
- Consider enhancing disclosure on **board refreshment** policies and efforts
- **Director skills matrices** have quickly become the norm for large cap proxy statements



*__Source__: *ISS Governance, Board Elections and Executive Compensation in the 2023 U.S. Proxy Season* (director support data); *Spencer Stuart, 2023 U.S. Spencer Stuart Board Index* (skills matrix data)

Board Diversity*

Diversity Disclosures Increase Despite DEI Uncertainty

- Increased **scrutiny on workplace affirmative action** programs and **heightened litigation risk** following Supreme Court's college and university admissions decision
- Many companies are reviewing their DEI-related programs and disclosures
- Expect tension with **SEC human capital disclosure rules** now expected to be proposed in 2024, **Nasdaq** "comply or explain" rule to have **two diverse directors** by August 2025 and **board diversity disclosure rules** SEC expects to propose in October 2024
- **Proxy advisory firms** continue to hone their approaches on diversity issues:
- **Glass Lewis** expanded its definition of "underrepresented community director" to include someone who self-identifies as "a member of the LGBTQIA+ community" rather than someone who self-identifies as "gay, lesbian, bisexual, or transgender"
- **ISS E&S QualityScore** updates in 2023 added **gender disclosure** and **gender pay gap** factors to its tracking of workforce diversity and equality factors
- Companies continue to expand **diversity-related disclosures**
- **56%** of **S&P 500** companies disclose a **Rooney Rule-type commitment** to include diverse candidates in searches, versus **50%** in 2022
- Disclosure of **board composition** varies by category

98% disclose **gender diversity**

97% disclose **under-represented minority** representation

25% disclose **LGBTQ+** representation

6% disclose **veteran** representation

**Source*: *Spencer Stuart, 2023 U.S. Spencer Stuart Board Index*

Proxy Advisor / Institutional Investor Concerns

Proxy Advisor Policy Updates

- **ISS announced several policy updates, including:**
  - ISS E&S QualityScore updates in 2023 enhanced its approaches on topics including labor relations, gender equity, human rights and natural resources / climate-related issues
  - ISS Governance QualityScore updates in 2023 enhanced its approaches on topics including board structure, compensation and shareholder rights
  - Limited benchmark voting policy updates for international markets (no U.S. updates)
- **Glass Lewis announced several policy updates, including:**
  - New policies on material weaknesses and executive ownership guidelines
  - Revised policies on clawback policies, cyber risk oversight, board oversight of E&S issues, director accountability for climate-related issues, and net operating loss poison pills
- **Companies should review last year's ISS and Glass Lewis reports to identify areas for improvement, either during the engagement process or when enhancing proxy statement disclosures**

Don't Forget About Overboarding

- Proxy advisors and institutional advisors continue to refine **board overboarding limits**

Delaware Law and Litigation Dynamics

Potential Issues to Avoid to Ease Annual Meeting Planning

DGCL 219 Stockholder Lists

- **ELIMINATED** previous requirement that the list of stockholders entitled to vote at a meeting be **made available at a virtual meeting**
- **CLARIFIED** timing for providing the stockholder list, which must be made available for a 10-day period ending **on the day before** the meeting date

DGCL 242 Voting Standards*

- **REDUCED** default threshold to approve COI amendments for reverse stock splits (and a corresponding decrease in authorized shares) to the **affirmative vote of a majority of votes cast**
- **ELIMINATED** need for a shareholder meeting or vote to implement a forward stock split (and a corresponding increase in authorized shares) for companies with one class of stock

Litigation Recent Developments

- Increasing books and records demands and litigation around voting standard disclosures
- Critical to double-check governing docs and state law to confirm (and accurately disclose) applicable voting standard for each proposal
- Includes broker-non-vote disclosures; consider revisiting these given interplay of SEC disclosure requirements and NYSE determination dynamics

**These voting standards will apply as the default procedures going forward, absent conflicting provisions in a company's charter.*

SEC Expected to Continue to Drill Down on Leadership and Risk Oversight Disclosures

SEC expected to review 2024 proxy statements more closely for topics covered in late 2022 comment letter sweeps

- **Board leadership structure** comment letters focused on:
  - Whether company may combine CEO and board chair roles and whether shareholders would receive advance notice / input opportunities
  - How lead independent director's experience fits into risk oversight
  - Lead independent director's role, including specific responsibilities

- **Risk oversight** comment letters focused on:
  - Risk evaluation timeframes
  - Application of oversight standards based on the risk's immediacy
  - Whether board consults with outside advisors to anticipate future trends
    - How often board reassesses risk environment
    - Interaction with management around emerging risks
    - Whether company has a CCO and CCO's reporting line
    - How board's risk oversight processes align with disclosure controls
    - How the lead independent director's experience fits into risk oversight

~5%

of, or 26, S&P 500 companies received board leadership comments

~9%

of, or 46, S&P 500 companies received risk oversight comments

Comp-Related Rule Changes

Pay vs. Performance Trends and Considerations

- In November 2023, SEC **issued eight** and **revised two C&DIs** further clarifying disclosure requirements, following prior C&DIs issued in February and September 2023
    - PvP disclosures will be required to look back four years in 2024 (FYs 2020, 2021, 2022 and 2023)—will eventually cover information for a five-year period
- Disclosure **may be taken into account** by proxy advisory firms
    - ISS: will not consider the disclosure in its quantitative pay-for-performance assessment, but may do so in its qualitative evaluation
    - Glass Lewis: disclosure "may be used" in the supplemental quantitative assessments that support the firm's pay-for-performance grade of reviewed companies
- While disclosure practices varied, **2023 trends** included using:
    - Graphs to compare compensation actually paid ("CAP") to other metrics
    - A non-GAAP measure as the company-selected measure
    - Three to five metrics for the required tabular list of most important performance measures
    - Consultants to assist with calculating CAP

Clawback Policy Requirements Now Live

- NYSE and Nasdaq companies by now should have adopted **clawback policies** in accordance with SEC and listing exchange rules
- **Glass Lewis** expects policies to not only **comply with the exchange rules**, but to also meet enhanced standards by further **accounting for problematic behavior**
- Remember to update **CD&A** disclosure to cover **clawback policy** (if not in 10-K)

Proxy Disclosure Effectiveness

Making the Most of Your Proxy

- Annual meetings are becoming **increasingly challenging** (broker non-votes, brokers refusing to exercise discretionary vote, increasing influence of proxy advisors, proxy voting choice programs at large asset managers)
- The proxy statement is a key **shareholder engagement tool** (not just a compliance doc)
- Important to **effectively articulate** your story, otherwise no one will listen

AUDIENCE

- Does the proxy statement address important information for **each of the key parties** that will be tuned in?

CLARITY

- Is the proxy dominated by **large blocks** of dense text and/or "**legalese**"?
- Could it be updated with more **headlines**, **plain language** and **graphics**?

ORGANIZATION

- Does the proxy statement structure **prioritize the topics of most interest to readers**?
- Are routine or **repeated yearly disclosures** near the end of relevant sections?

DESIGN

- Is the design of each section **easy to follow**?
- Is the proxy **easy to read**, and are graphics clear?
- Can readers **easily find** information of interest?

Technical Rule Change Reminders

Additional Reminders for Your 2024 Proxy

Confirm proxy statement's cover page incorporates most recent updates to Schedule 14a-101

Confirm Section 16 disclosures reflect recent rulemakings, and reconfirm related controls in light of recent SEC enforcement sweeps

Remember "glossy" annual report (Form ARS) filing obligations

Update deadlines for universal proxy nominee submissions under Rule 14a-19 / bylaw amendments

Shareholder Proposals*

Looking Back at 2023

- In 2023, the number of proposals increased from 2022 by 2% to 889—exceeding last year's record for the highest number of shareholder proposal submissions since 2016
- Executive compensation proposals were up 108% from 2022, and environmental and social proposals continued to increase, up 11% and 3%, respectively, since 2022
- While only 175 no-action requests were submitted in 2023, overall success rates rebounded to 58% from 2022's historic low of 38%
  - Success rates improved for duplicate proposals, and for procedural, ordinary business and substantial implementation, but declined for resubmissions and violations of law
- Over 54% of proposals submitted were voted on, following an increase to 50% in 2022
  - Average support plummeted to 23.3% in 2023, following a decrease to 30.4% in 2022—and only 25 proposals passed, down from 55 in 2022

Looking Ahead to 2024

- Be thorough and thoughtful in procedural reviews
- First time or relatively new proponents continue to emerge
- In keeping with last year, there is continued growth in narrowly focused single-issue social proposals on topics such as animal welfare and plastics
- Expect a continued trend in E&S-skeptical proposals (e.g., challenging assumptions about the benefits of renewable energy transitions)
- Proponents likely to continue using exempt solicitations in support of proposals in proxies

**Source*: *Derived from Gibson Dunn's internal data and Institutional Shareholder Services ("ISS") publications and the ISS shareholder proposals and voting analytics databases, with only limited additional research and supplementation from additional sources*

Management Proposal Reminders

In Addition to the Usual Suspects…

- Director Elections
- Say on Pay
- Auditor Ratification (important for quorum)

…Do You Need a Say on Frequency Vote?

- Every six years

…How Are Your Share Counts?

- Now is the right time to **check both your equity plan and authorized share reserves** to assess if you have enough shares
- Often need **cross-functional input**
- **Certificate amendment to increase authorized shares** requires **preliminary proxy** filing
- Be sure to confirm **voting thresholds**

…Don't Forget a Preliminary Proxy (if applicable)

- **Charter and bylaw amendments** put to a shareholder vote require a preliminary proxy filing at least **10 days prior** to definitive proxy filing, but consider if there is enough time to push filing of definitive proxy if SEC provides comments

Changes for 2025 to Start Thinking About Now

Timing of Equity Awards vs. Release of MNPI

- New Item 402(x) of Regulation S-K will require award timing disclosure, in either the fiscal year 2024 Form 10-K or the 2025 proxy statement
- **2024 grants will be the first to be reported on under the new requirement**
- **Narrative** disclosure to cover:
- **Policies and practices** on the timing of stock options in relation to MNPI disclosure
- Includes how the board **determines when to grant** such awards
- Whether / how the board **takes MNPI into account** for award timing
- Whether the company **has timed the disclosure** to affect the award's value
- **Tabular** disclosure, as shown below, to cover awards made near in time to filing / furnishing documents containing **MNPI**
- Only required for **NEO** awards
- Required for awards **four business days *before***, or **one business day *after*** such filing

Name	Grant date	Number of securities underlying the award	Exercise price of the award ($/Sh)	Grant date fair value of the award	Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information
[NEO]					

Upcoming SEC Rulemaking on Corporate Disclosures

03

Climate Change (Proposed SEC Rule)

- **Background**: The SEC issued a rule proposal to enhance and standardize climate-related disclosures for investors on March 21, 2022.
- **Overview**: the SEC proposed new climate-related disclosure requirements for both domestic and foreign registered companies, including:
  - **Risks** – Climate-related risks and their actual or likely material impacts on the company's business, strategy, and outlook;
  - **Governance/Risk Management** – The company's governance of climate-related risks at both the board and management level, and relevant risk management processes, including whether the company has a board member with climate risk expertise;
  - **Emissions** – The company's greenhouse gas ("GHG") emissions, which, for accelerated and large accelerated filers and with respect to Scope 1 and Scope 2 emissions, would be subject to assurance (limited or reasonable, as indicated on the table on the following slide) and an attestation report from an independent attestation service provider; also with respect to Scope 3, but only if material or if GHG emissions reduction target/goal that includes Scope 3 emissions has been set;
  - **Financial Statements** – Certain climate-related financial statement metrics and related disclosures (such as the impact of climate-related events and transition activities) in a note to its audited financial statements; and
  - **Goals and Transition Plans** – Information about climate-related targets, goals and transition plan, if any, including how the company intends to meet the goal and data indicating any progress.

Climate Change (California Final Rule)

- In September 2023, the California Legislature passed two wide-reaching bills that will impose **significant and mandatory climate-related reporting requirements for large public and private companies** doing business in the state, which Governor Newsom signed into law (with some reservations) in October 2023
- **S.B. 253: Climate Corporate Data Accountability Act**
  - Who it would apply to: all U.S. businesses with >$1B in annual revenue that "do business" in California
  - What disclosure would be required: Scope 1, 2 & 3 GHG emissions in line with the GHG Protocol, and independently verified by an approved third-party auditor
  - How it's different from the proposed SEC rules: Scope 3 would be required in all cases (even if immaterial) and third-party verification could, depending on CARB regulations, cover Scope 3 (not just Scope 1 & 2)
  - When it would become effective: first disclosures required in 2026 based on 2025 emissions, with assurance requirements phasing in between 2026-2030
- **S.B. 261: Climate-Related Financial Risk Act**
  - Whom it would apply to: all U.S. businesses (other than insurance companies) with >$500M in annual revenue that "do business" in California
  - What disclosure would be required: a biennial report on the company's climate-related financial risk (i.e., material risk of harm to immediate and long-term financial outcomes due to physical and transition risks) in accordance with TCFD framework, and measures adopted to reduce and adapt to such financial risks
  - When would it become effective: first disclosures required in 2025

Shareholder Proposals (Proposed Rule)

- **Background**: On July 13, 2022, the SEC issued a rule proposal that would significantly narrow three bases for excluding shareholder proposals.
- **Proposed Changes**:
  - **Substantial Implementation**
    - Rule Proposal: The staff would focus on the ***essential elements*** of a shareholder proposal to assess whether the company's prior actions taken to implement the substance of the shareholder proposal are sufficiently responsive, as compared to the current standard which assesses whether a company's practices ***compare favorably***. In order to exclude a shareholder proposal, a company would need to have implemented ***each of the essential elements*** of the proposal.
  - **Duplication**
    - Rule Proposal: Proposals are duplicative only when they address the ***same subject matter*** and ***seek the same objective by the same means*** instead of when the two proposals have the ***same principal thrust or focus.***
  - **Resubmission**
    - Rule Proposal: The proposal would change the standard for the resubmission exclusion from "***substantially the same subject matter***" to "***substantially duplicates***," using the same analysis as that basis.

Human Capital (Not Yet Re-Proposed)

- **Background**: SEC expected to propose rules amending existing requirements to require more prescriptive human capital management disclosures in 10-Ks
- **Reg Flex Date**: April 2024
- **How Disclosures Would Change**: current disclosure rules are principles-based, requiring a description of human capital resources and human capital measures the company uses to manage the business, which has largely resulted in qualitative disclosure; based on remarks from the SEC, the new rules are likely to be more prescriptive and include "metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety"
- **SEC Investor Advisory Committee Recommendations**: in September 2023 voted to recommend adding requirements to disclose # of employees (broken down by full time, part time, contingent workers), turnover metrics, total cost of workforce (broken down by major compensation components), demographics data

Board Diversity (Not Yet Proposed)

- **Background**: SEC expected to propose rules requiring proxy disclosure of directors' voluntary self-ID'd diversity characteristics similar to Nasdaq requirements

- **Reg Flex Date**: October 2024
- **Practical Considerations**
  - Consider existing SEC rules – in some cases already required
  - Consider your investors – many have specific expectations here
  - Consider market practice – your Nasdaq & non-Nasdaq peers may already be doing this
  - Consider impact of the recent Supreme Court case and related State AG letters – optics matter

SEC’s New Private Funds Rules

04

Overview of Key Requirements and Restrictions

Overview of Key Requirements and Restrictions

New Private Funds Rules

On August 23, 2023, the SEC by a 3-2 vote adopted final rules under the Advisers Act, with the asserted goal of bringing "transparency" to the inner workings of private funds and their sponsors:

1. Preferential Treatment Rule
2. Quarterly Statement Rule
3. Private Fund Audit Rule
4. Adviser-Led Secondaries Rule
5. Books and Records Rule Amendments
6. Restricted Activities Rule
7. Compliance Rule Amendments

Overview of Key Requirements and Restrictions

Preferential Treatment Rule

Requirement or Restriction	• Advisers must provide ***advance disclosure of material economic terms*** granted preferentially to other investors before admitting new investors to the fund • Advisers must disclose ***all other preferential treatment*** "as soon as reasonably practicable": a. After the end of the fundraising period (for illiquid funds) or the investor's investment (for liquid funds); and b. At least annually thereafter (if new preferential terms are granted since the last notice). • **Redemption Rights**: An adviser may not offer preferential redemption terms if the adviser reasonably expects doing so to have a *material, negative effect* on other investors, unless such ability is required by law or offered to all other investors in the fund. • **Portfolio Holdings Information**: An adviser may not provide preferential information about portfolio holdings or exposures if the adviser reasonably expects that doing so would have a *material, negative effect* on other investors, unless such preferential information is offered to all investors.
Other Considerations	• Compliance Date: • September 14, 2024 for advisers with $1.5B of private fund assets • March 14, 2025 for all other advisers • Existing Funds Grandfathered? • For disclosing material preferential terms to other investors – **No** • For redemption rights and portfolio holdings information – **Yes**

Overview of Key Requirements and Restrictions

Quarterly Statement Rule

Requirement or Restriction	• Registered advisers must issue standardized ***quarterly statements*** detailing information regarding: a. Fund-level performance; b. Costs of investing in the fund, including itemized fund fees and expenses; c. Any offsets or fee waivers; and d. An itemized accounting of all amounts paid to the adviser or its related persons by each portfolio company.
Other Considerations	• Compliance Date: • March 14, 2025 • Existing Funds Grandfathered? • No

Overview of Key Requirements and Restrictions

Private Fund Audit Rule

Requirement or Restriction	• Registered advisers must obtain for each private fund client an annual audit that meets the requirements of the audit provision in the Advisers Act custody rule (Rule 206(4)-2), and will no longer be able to opt out of the requirement using surprise examinations.

Other Considerations	• Compliance Date:
	  • March 14, 2025
	• Existing Funds Grandfathered?
	  • No

Overview of Key Requirements and Restrictions

Adviser-Led Secondaries Rule

Requirement or Restriction	• Registered advisers must obtain and distribute an **independent fairness opinion or valuation** opinion in connection with an adviser-led secondary transaction, and **disclose material business relationships** the adviser has had in the **last two years** with the opinion provider.

Other Considerations	• Compliance Date:
	  • September 14, 2024 for advisers with $1.5B of private fund assets
	  • March 14, 2025 for all other advisers
	• Existing Funds Grandfathered?
	  • No

Overview of Key Requirements and Restrictions

Books and Records Rule Amendments

Requirement or Restriction	• Requirement to maintain certain books and records demonstrating compliance with the Final Rules.

Other Considerations	• Compliance Date:
	  • Based on the compliance date of the underlying rule for which records are required
	• Existing Funds Grandfathered?
	  • No

Overview of Key Requirements and Restrictions

Restricted Activities Rule (Investigation Costs)

Requirement or Restriction	• An adviser may not allocate to a private fund any **fees or expenses associated with an investigation of the adviser without disclosing** as much **and receiving consent from a majority in interest** of unaffiliated fund investors. • An adviser is **prohibited from charging a fund for fees and expenses for an investigation that results or has resulted in a sanction** for a violation of the Advisers Act or the rules thereunder.

Other Considerations	• Compliance Date:
	  • September 14, 2024 for advisers with $1.5B of private fund assets
	  • March 14, 2025 for all other advisers
	• Existing Funds Grandfathered?
	  • Yes, if disclosed

Overview of Key Requirements and Restrictions

Restricted Activities Rule (Regulatory/Compliance Costs)

Requirement or Restriction	• Advisers may not charge or allocate to the private fund regulatory, examination, or compliance fees or expenses unless they are disclosed to investors within 45 days after the end of the fiscal quarter in which such charges occur.

Other Considerations	• Compliance Date:
	  • September 14, 2024 for advisers with $1.5B of private fund assets
	  • March 14, 2025 for all other advisers
	• Existing Funds Grandfathered?
	  • Yes, if disclosed

Overview of Key Requirements and Restrictions

Restricted Activities Rule (After-tax Clawback)

Requirement or Restriction	• Advisers may not reduce the amount of a GP clawback by amounts due for certain taxes unless the pre-tax and post-tax amounts of the clawback are disclosed to investors within 45 days after the end of the fiscal quarter in which the clawback occurs.

Other Considerations	• Compliance Date:
	  • September 14, 2024 for advisers with $1.5B of private fund assets
	  • March 14, 2025 for all other advisers
	• Existing Funds Grandfathered?
	  • Yes, if disclosed

Overview of Key Requirements and Restrictions

Restricted Activities Rule (Non-*pro rata* investment-level allocations)

Requirement or Restriction	• Advisers may not charge or allocate fees or expenses related to a portfolio investment on a non-*pro rata* basis when multiple funds and other clients are invested, unless the allocation is "***fair and equitable***" • The adviser must distribute advance notice describing the charge and justifying its fairness and equitability

Other Considerations	• Compliance Date:
	  • September 14, 2024 for advisers with $1.5B of private fund assets
	  • March 14, 2025 for all other advisers
	• Existing Funds Grandfathered?
	  • Yes, if disclosed

Overview of Key Requirements and Restrictions

Restricted Activities Rule (Borrowing from the fund)

Requirement or Restriction	• Advisers may not borrow or receive an extension of credit from a private fund without disclosure to and consent from fund investors

Other Considerations	• Compliance Date:
	  • September 14, 2024 for advisers with $1.5B of private fund assets
	  • March 14, 2025 for all other advisers
	• Existing Funds Grandfathered?
	  • Yes, for pre-existing loans

Overview of Key Requirements and Restrictions

Compliance Rule Amendment

Requirement or Restriction	• All registered advisers (including those without private fund clients) must document in writing the required annual review of their compliance policies and procedures.

Other Considerations	• Compliance Date
	  • November 13, 2023
	• Existing Funds Grandfathered?
	  • N/A

Applicability to Various Types of Sponsors

Applicability to Various Types of Sponsors

Which of the Final Rules apply to various types of sponsors?

Registered investment advisers to private funds are subject to all of the rules and restrictions.

Exempt reporting advisers and other unregistered advisers are not affected by the Quarterly Statement Rule, the Private Fund Audit Rule, the Adviser-Led Secondaries Rule or the Compliance Rule Amendment, but they are subject to the Preferential Treatment Rule and the Restricted Activities Rules.

Offshore advisers whose principal place of business is outside the U.S., whether registered or unregistered, are technically subject to the Final Rules, but the SEC has indicated that it will not extend the requirements of these rules to the adviser's activities with respect to their offshore private fund clients, *even if the offshore funds have U.S. investors*.

Applicability to Various Types of Sponsors

Which of the Final Rules apply to various types of sponsors (cont'd)?

The Quarterly Statement Rule, Private Fund Audit Rule, Adviser-Led Secondaries Rule, Restricted Activities Rule and Preferential Treatment Rules do not apply to investment advisers with respect to:

- **Securitized asset funds** they advise
- **Real estate funds relying on Section 3(c)(5)(C)**
- **Other collective investment vehicles that are not "private funds"**

Real estate fund managers that are not registered with the SEC (or filing reports as an exempt reporting adviser) on the basis that they are not advising on "securities" are not subject to the Advisers Act or the Final Rules.

A Closer Look: Preferential Treatment Rule

A Closer Look: Preferential Treatment Rule

Summary of the Preferential Treatment Rule

Sponsors will now have to disclose:

i. Fee and carry breaks or other material economic arrangements preferentially granted to other investors ***ahead*** of admitting new investors into their private funds;

ii. All preferential treatment as soon as reasonably practicable after the final closing of a closed end fund or the admission of the new investor in an open-end fund; and

iii. At least annually thereafter if preferential terms are provided that were not previously disclosed.

- Increase in organizational expense costs for sponsors as a result

A Closer Look: Preferential Treatment Rule

What is Considered a "Material Economic Term"?

Examples given by the SEC:

- The cost of investing
- Liquidity rights
- Fee breaks
- Co-investment rights

A Closer Look: Preferential Treatment Rule

What is the Impact on the MFN Process?

Sponsors will now have to conduct a portion of their MFN process in piecemeal fashion, with part of the process conducted prior to the final closing and the rest conducted post final closing.

This will occur with respect to each investor regardless of whether such investor negotiated a side letter with an MFN clause or is entitled to elect any of the disclosed provisions.

This will curtail the common practice of only showing other investors' side letter provisions to those investors with MFN provisions and of only showing investors those provisions which they are eligible to elect.

Due to the ongoing disclosure requirements, those sponsors of closed-end funds which already held their final closings and ran a more limited MFN process will now be required to disclose any preferential treatment granted to other investors, regardless of size, that had not been previously disclosed.

There is no requirement to offer the election of such provisions to the investors who receive the disclosure.

Smaller investors that were not previously given preferential terms may now request in light of disclosure requirements.

A Closer Look: Quarterly Statement Rule

A Closer Look: Quarterly Statement Rule

Quarterly Statement Rule: Three Main Buckets

Fund-Level
Fee, Compensation and Expense Disclosure

Portfolio Company-Level
Fee, Compensation and Expense Disclosure

Performance Information

A Closer Look: Quarterly Statement Rule

Fund-Level Fee, Compensation and Expense Disclosure

1. A detailed accounting of **all compensation, fees, and other amounts** allocated or **paid to the adviser** or any of its related persons **by the private fund** during the reporting period, including, but not limited to:
    - Management, advisory, sub-advisory, or similar fees or payments, and performance-based compensation (*e.g.*, carried interest)
2. A detailed accounting of **all fees and expenses** allocated to or **paid by the private fund** during the reporting period other than those listed in (1), including, but not limited to:
    - Organizational, accounting, legal, administration, audit, tax, due diligence, and travel fees and expenses
3. The amount of any **offsets or rebates carried forward** during the reporting period to subsequent quarterly periods to reduce future payments or allocations to the adviser or its related persons

A Closer Look: Quarterly Statement Rule

Portfolio Investment-Level Fee and Compensation Disclosure

Similar to the above, the Quarterly Statement Rule requires registered investment advisers to disclose a detailed accounting of all ***portfolio investment compensation*** allocated or paid by each ***covered portfolio investment*** during the reporting period in a single, separate table from the disclosure table noted above.

"Portfolio investment compensation" includes any compensation, fees, and other amounts allocated or paid to the adviser or any of its related persons by the portfolio investment attributable to the private fund's interest in the portfolio investment, including but not limited to origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition, directors, trustees or similar fees or payments.

Detailed line-by-line itemization of all portfolio investment compensation.

Must list the portfolio investment compensation allocated or paid **both before and after the application of any offsets, rebates or waivers**.

- However, it is not clear how this is intended to apply, as such offsets are taken into account at the fund level, not the portfolio company level.

A Closer Look: Quarterly Statement Rule

Performance Disclosure

Liquid Funds	• Show performance based on: A. annual net total return for each fiscal year for the 10 fiscal years prior to the quarterly statement or since inception (whichever is shorter); B. average annual net total returns over one-, five-, and 10-fiscal-year periods; and C. cumulative net total return for the current fiscal year as of the end of the most recent fiscal quarter.
Illiquid Funds	1. Show performance based on: • IRR and MOIC (both gross and net metrics shown with equal prominence) (A) since inception and (B) for the realized and unrealized portions of the illiquid fund's portfolio, with the realized and unrealized performance shown separately. 2. Present a statement of contributions and distributions.

A Closer Look: Quarterly Statement Rule

General

Advisers must comply with the quarterly statement requirement for a new fund once it has had two full fiscal quarters of operating results

Granular detail about what information needs to be **clearly and prominently disclosed**

- Including methodologies and assumptions made in calculating performance information

Cross-references to the sections of the private fund's organizational documents that set forth the methodology

Separate line items for each category of compensation, fee or expense and that the exclusion of *de minimis* expenses, the grouping of smaller expenses into broad categories or the labeling of any expenses as miscellaneous is prohibited

Anticipated that this will increase costs to advisers and funds significantly

Must distribute the quarterly statements to the private fund's investors within:

- **45** days after the end of the first three fiscal quarters of each fiscal year and within **90** days after the end of each fiscal year
- For fund of funds, within **75** days after the end of the first three fiscal quarters of each fiscal year and within **120** days after the end of each fiscal year

Timing deadlines expected to present significant operational challenges for sponsors, particularly for fund of funds

Legal Challenge Update

Legal Challenge Update

General

On September 1, 2023, a broad coalition representing venture capital, private equity, credit, and hedge fund advisers petitioned for review of the final rules in the U.S. Court of Appeals for the Fifth Circuit.

The SEC **exceeded its statutory authority** and **violated the requirements for agency rulemaking** in multiple ways.

- The SEC does not have the authority to subject private funds to the type of prescriptive regulations imposed by the final rules.
- The SEC has not shown any need for the onerous rules it has adopted, and has made no attempt to justify their exorbitant cost—cost that will be borne by the very investors the Commission claims to protect.
- While the final rules purport to water down the most extreme parts of the proposed rules by adding disclosure and consent exceptions, the SEC never subjected those exceptions to public comment, and they act as *de facto* bans on the targeted practices due to their overall unworkability.

Statutory Authority

The rules exceed the SEC's authority

The SEC claims to have found a sweeping power to regulate private fund advisers in a section of the Dodd-Frank Act concerning ***retail*** customers—a section that does not mention private funds.

- Congress carefully delineated between registered investment companies (such as mutual funds) and private funds. Registered investment companies—serving ordinary retail investors—are governed by the Investment Company Act, which sets forth detailed rules governing almost every aspect of investment companies' operations. *See* 15 U.S.C. § 80a-1 to -64. Congress deliberately chose to exempt private funds from this intrusive regime. *See id.* § 80a-3(c)(1), (c)(7).
- The SEC asserts that it has authority to adopt the final rules under sections 211(h) and 206 of the Advisers Act, but neither provision supports the agency's actions.
- Section 211(h) is a clean-up provision tacked on to a section of the Dodd-Frank Act addressing the provision of advice to ***retail*** customers.
- Section 206(4) grants the SEC authority to "define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative," 15 U.S.C. § 80b-6(4), but the SEC fails to "define" the allegedly fraudulent acts, and fails to explain how the final rules would prevent those (undefined) acts.

Arbitrary and Capricious

The final rules are unnecessary and unduly burdensome

"Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decisionmaking." *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 843 (D.C. Cir. 2006) (Kavanaugh, J.).

Investors in private funds are some of the most sophisticated investors in the world, and they have, year over year, voluntarily ***increased*** their investments in private funds. The SEC has identified no firm basis for the intrusive, costly rules it adopted.

Requirements for Agency Rulemaking

The SEC's economic analysis is flawed

The SEC has a special statutory obligation to consider whether the rules "will promote efficiency, competition, and capital formation." 15 U.S.C. § 80b-2(c).

- Courts have frequently struck down SEC rules for errors in the agency's economic analysis. *See*, *e.g.*, *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011); *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010); *Chamber of Com. of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).
- Here, for example, the SEC's treatment of competition and capital formation is flawed.
- The SEC asserts that the final rules will expand competition by creating opportunity for new or smaller advisers to compete with larger advisers.
- But the SEC simultaneously seeks to downplay the cost of the final rules by suggesting that smaller advisers may reduce their size to avoid some of the regulations.

The APA requires an agency to "give interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments." 5 U.S.C. § 553(c).

- Here, the SEC seriously overreached in its proposed rule and then changed that proposal dramatically without further notice to the public or opportunity to comment on those changes or the SEC's analysis of them.

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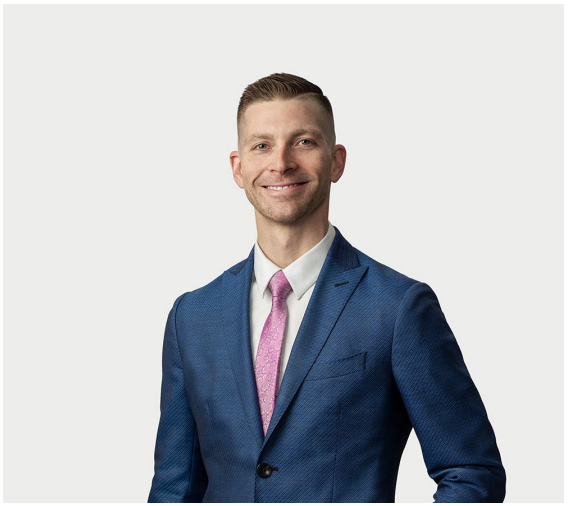

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