

Davis Polk

Preparing your 2022 Form 20-F: Hot topics and developments to watch in the U.S. and U.K.

Presented by **Connie Milonakis | Maxim Van de moortel**
Dan Hirschovits | Sophie Vacikar Bessisso

January 26, 2023

Hot Topics

Macroeconomic environment

U.S. considerations

- Registrants should make adequate disclosures in areas of emerging risk, including risks associated with the Russia/Ukraine war, supply chain issues and inflation.
 - On May 3, 2022, the SEC published a sample comment letter, stating that companies may have disclosure obligations under the federal securities laws related to the direct or indirect impact that Russia's invasion of Ukraine and the international response thereto have had or may have on their business.
 - Current economic conditions might require additional disclosure beyond what has historically been provided in a more steady-state economic environment.
 - Heightened cybersecurity risks, increased or ongoing supply chain challenges and volatility related to trading prices of commodities (whether or not associated with Russia/Ukraine war) warrant disclosure.
- On December 8, 2022, the SEC published a sample comment letter to companies regarding crypto asset market-related disclosure obligations, highlighting that companies should evaluate and disclose whether their business experienced or may be affected by recent developments in crypto assets.

U.K. considerations

- FRC's Annual Review of Corporate Reporting (21/22) highlights that companies should ensure adequate reporting on risks in uncertain times:
 - Remain agile and continually reassess the evolving risks, which need to be reflected in their strategy and reporting.
 - Provide clear explanations of the risks and changes in the business environment they are facing and how the risks and uncertainties have been reflected in their strategy, business model and going concern and viability assessments.
 - Adequately explain any changes to definitions or calculations implemented as a result of changes in the macroeconomic environment (e.g., inflation adjusted measures).
- Companies need to consider and include in their strategic report how resilient their business model is to inflationary environment; changes to the principal risks and uncertainties and the related mitigation actions; and the impact of inflation on suppliers, customers and employees.

Hot Topics

Climate

U.S. considerations

- On September 22, 2021, the SEC published a sample comment letter regarding registrants' climate-related disclosure or the absence thereof.
 - The SEC may require disclosure related to:
 - Climate change-related risks and opportunities in a company's description of business, legal proceedings, risk factors and management's discussion and analysis of financial condition and results of operations.
 - The impact of pending or existing climate-change related legislation, regulations, and international accords.
 - The indirect consequences of regulation or business trends.
 - The physical impacts of climate change.
- On March 21, 2022, the SEC also proposed a sweeping climate disclosure regime for public companies, requiring disclosure of climate-related risks, greenhouse gas emissions and climate-related financial metrics not previously required by the SEC.

U.K. considerations

- FRC's Annual Review of Corporate Reporting (21/22) highlights that companies could significantly improve climate-related reporting by providing:
 - Granularity and specificity with regards to climate-related disclosures.
 - Balance in discussion of climate-related risks and opportunities.
 - Linkage of TCFD disclosures with other narrative disclosures and connectivity with financial statements disclosures.
 - Explanation of materiality applied in the context of TCFD disclosures.
- Under the Listing Rules, for reporting periods beginning on or after January 1, 2022, standard listed companies are now required (in addition to premium listed companies) to provide climate reporting consistent with TCFD recommendations on a "comply or explain" basis.
- The Companies Act 2006 has introduced mandatory (TCFD aligned) annual climate-related financial disclosures for large publicly quoted companies, large private companies and LLPs, for financial years beginning on or after April 6, 2022.
 - New Non-Financial and Sustainability Information Statement in Strategic Report

Hot Topics

Cybersecurity

U.S. considerations

- The SEC has recently stepped up cybersecurity disclosure enforcement, including:
 - For failure to provide timely or adequate notice of a material cybersecurity incident in Form 6-K or in subsequent filings;
 - For failure to adequately disclose, or for overstating, the nature of the company's policies and procedures, management and governance of cybersecurity risks; and
 - Increasing the likelihood of an SEC finding that the company lacks adequate cybersecurity controls because it does not maintain some of the policies and procedures described in the proposal.
- On March 9, 2022, the SEC also proposed new cybersecurity disclosure rules for public companies, requiring disclosures on cybersecurity risk management and material cybersecurity incidents in periodic filings.

U.K. considerations

- FRC's Lab Report on Digital Security and Risk Disclosure (August 2022) identifies that current digital security risk disclosures do not meet investor and other stakeholder needs as they are often boilerplate and do not reflect changes in risks, business model or business environment.
- The FRC encourages companies to consider disclosures that:
 - Explain how digital security and strategy is important to the company's current and future business model, strategy and environment.
 - Detail the governance structures, culture and processes the company has in place to support digital security and strategy.
 - Identify digital security and strategy risks and opportunities the company is facing both now and in the future.
 - Highlight the impact of internal and external events and the actions and activities that respond to these.
- To strengthen digital security disclosures, the Government proposes to legislate to require disclosure regarding the ability of companies to manage digital security risks (including cybersecurity threats and significant breaches of data protection obligations) under a new statutory Resilience Statement.

Hot Topics

Non-GAAP financial measures / APMs

U.S. considerations

- The SEC continues to scrutinize non-GAAP financial measures.
 - The SEC has brought charges for false and misleading disclosures concerning the calculation of non-GAAP financial measures.
- The SEC published new and updated CD&Is on December 13, 2022 addressing non-GAAP financial measures:
 - Two revised CD&Is (100.01 and 100.04) provide guidance on non-GAAP adjustments or recognition principles that could result in the presentation of a non-GAAP measure being misleading.
 - CD&I 102.10 was revised to provide more guidance on the staff's interpretation of "more prominent" with more granular examples than were previously included as well as the staff's view as to what they consider to be a non-GAAP income statement.
 - Two new CD&Is (100.05 and 100.06) provide guidance on the need to properly label and describe non-GAAP measures and stress that extensive disclosure about the nature of the non-GAAP measure does not necessarily prevent that measure from being misleading.

U.K. considerations

- The FRC continues to scrutinize use of APMs in corporate reporting and expects companies to continue to apply the ESMA Guidelines when preparing annual and interim reports.
- FRC's Annual Review of Corporate Reporting (21/22) highlights that companies should ensure that:
 - APMs are not displayed with more prominence, emphasis or authority than measures directly stemming from financial statements.
 - The basis for classifying amounts as adjusting, "non-underlying" or "non-core" and any changes to APMs are explained, together with the reasons for those changes.
 - APMs are reconciled to the most directly reconcilable line item of the financial statements.

Recent Developments

Board diversity rules

U.S. considerations

- Nasdaq’s new board diversity rules require Nasdaq-listed companies, including FPIs, to have diverse board members or explain why they do not.
 - FPIs must have at least two board members who are female or have (i) one female director and (ii) one director who is LGBTQ+ or an “underrepresented individual” in their home country jurisdiction or explain why they do not have the requisite number of “diverse” board directors.
 - Companies with five or fewer board members must have at least one member who is diverse.
- The new rules will require FPIs (including those that do not have the requisite number of diverse directors) to publicly disclose the directors’ voluntary self-identified gender, racial characteristics and LGBTQ+ status in a prescribed matrix.
- Compliance under the new rules is subject to phase-in based on the Nasdaq listing tiers.

U.K. considerations

- The Listing Rules require board diversity disclosures on a “comply or explain” basis for U.K. incorporated premium and standard listed companies, for financial years beginning on or after April 1, 2022:
 - Whether specific gender and ethnicity diversity targets for boards and executive committees have been met:
 - 40% of board members are women.
 - At least one senior position of CEO, CFO, Chair or SID is held by a woman.
 - At least one director is from a minority ethnic background.
 - Numerical data on ethnic background and gender identity/sex with respect to boards and executive committees in the form of two prescribed tables set out in the Annexes to the Listing Rules.
- Parker Review targeted FTSE 100 companies having at least one director from an ethnic minority on boards by 2021 and FTSE 250 companies meeting target by 2024.
- Women Leaders Review recommends target of a minimum of 40% women on FTSE 350 boards and leadership; and at least one woman in chair or SID role and/or one woman in CEO or CFO role, by the end of 2025.

Recent Developments

Malus and clawback rules

U.S. considerations

- On October 26, 2022, the SEC adopted the final “clawback rule”, requiring listed companies to adopt a clawback policy to recover excess incentive compensation from executive officers if:
 - The incentive compensation was calculated based on financial statements that were required to be restated due to material noncompliance with financial reporting requirements, without regard to fault or misconduct.
 - Non-compliance resulted in overpayment of incentive compensation within a three-year lookback period.
- Each listed company must also:
 - File its clawback policy as an exhibit to its 20-F.
 - In the event of a restatement, disclose how much incentive compensation was subject to recovery, how much has remained outstanding for at least 180 days, and provide an explanation if it decides not to recover excess incentive compensation.

U.K. considerations

- The Companies Act 2006 contains established rules with regards to clawback and withholding in instances where remuneration of directors has not been declared and paid in accordance with shareholder approved directors’ remuneration policy.
- The U.K. Corporate Governance Code (the “**Code**”) supports this principle by emphasizing that remuneration policies should include provisions enabling a company to recover and/or withhold sums or share awards from executive directors and specify circumstances in which it would be appropriate to do so.
- Government proposes to invite the FRC to consult on how the existing malus and clawback provisions in the Code can be developed to deliver greater transparency and encourage consideration and adoption of a broader range of conditions in which executive remuneration could be withheld or recovered (beyond “gross misconduct” and “material misstatements”, which account for the majority of malus and clawback conditions currently).

Horizon Setting

U.S. considerations

Proposed climate disclosure rules

- On March 21, 2022, the SEC proposed a sweeping climate disclosure regime for public companies. The proposed disclosures include:
 - Climate-related risks, whether physical or transitional, reasonably likely to have a material impact over the short, medium and long term.
 - Greenhouse gas (GHG) emissions metrics (covering emissions categorized as Scope 1, Scope 2 and Scope 3) for the fiscal years included in the financial statements in the filing, including a description of the methodology, significant inputs and significant assumptions used to calculate GHG emissions.
 - Targets and goals relating to GHG reduction or any other climate-related target that a company has set, including data to indicate progress made toward achieving the target, to be updated annually.
 - Climate-specific governance disclosure, including the process by which the board exercises oversight and sets targets and goals, and the role of management in assessing and managing climate-related risks.
 - Financial statement footnote disclosure of certain climate-related matters.

Proposed cybersecurity disclosure rules

- On March 9, 2022, the SEC proposed new cybersecurity disclosure rules for public companies that would require disclosures regarding cybersecurity risk management in the Form 20-F and material cybersecurity incidents in periodic filings.
- In the Form 20-F, cybersecurity risk management disclosures include:
 - Policies and procedures for cybersecurity risk assessment.
 - Management's cybersecurity expertise and its role in managing cybersecurity risk and implementing policies and procedures.
 - Board-level governance around cybersecurity risk.
 - Identification of board member with cybersecurity expertise.

Horizon Setting

U.S. considerations (cont.)

Share repurchase disclosures modernization

- On December 15, 2021, the SEC proposed amendments regarding disclosure about an issuer's repurchases of its SEC-registered equity securities.
- The proposed amendments would require an issuer to disclose:
 - the objective or rationale for the share repurchases and the process or criteria used to determine the repurchase amounts;
 - any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restriction on such transactions; and
 - whether the issuer is making its repurchases pursuant to a plan that it intends to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c) and/or the conditions of the Exchange Act Rule 10b-18 non-exclusive safe harbor.

Human capital disclosures

- In August 2020, the SEC amended Item 101 of Regulation S-K to require that companies describe their human capital resources, including human capital measures or objectives that the company focuses on in conducting business.
- The SEC will most likely begin to scrutinize human capital resources disclosure more vigorously and, based on the SEC's Fall 2022 Regulatory Agenda, human capital resources disclosure rules continue to be expected (but have not yet been proposed).

Horizon Setting

U.K. considerations

Changes to UK Corporate Governance Code 2018

- The FRC has confirmed its intention to publish a revised Code, which would apply to periods commencing on or after January 1, 2024.
- Consultation on a revised Code and supporting material is outlined to take place in Q1 2023.
- The Code is expected to include revisions focusing on, *inter alia*, the effectiveness of internal controls around year-end reporting; audit tendering and market diversity; sustainability and ESG reporting; and reporting on malus and clawback arrangements.

ARGA turns up the heat

- The Government has confirmed its intention to replace the FRC with the Audit Reporting and Governance Authority (“**ARGA**”).
- The Government’s package of reforms will give ARGA a range of statutory responsibilities and powers that the FRC does not have, including, for example powers to:
 - Enforce and impose penalties on directors of PIEs for breaches of their statutory duties as they relate to corporate reporting and audit.
 - Direct changes to company reports and accounts (rather than having to seek a court order).
 - Obtain information from companies, accountants, auditors and relevant third parties; and to set minimum requirements for audit committees in relation to the appointment and oversight of auditors, and to require information and/or reports from audit committees.
- In addition, ARGA’s scope is expected to be extended to cover the entire contents of the annual report and accounts so that it can review elements such as corporate governance statements, directors’ remuneration and audit committee reports and CEO’s and Chair’s reports.

Horizon Setting

U.K. considerations (cont.)

New Corporate Reporting Disclosures

- Mixture of statutory and Code based reforms that will introduce new corporate reporting disclosures.
- Some of the new disclosures will be subject to a threshold introduced by a new definition of PIE, to include large private companies, AIM-traded companies and other entities (e.g., LLPs) that have 750+ employees globally and annual turnover of £750m+ (“**large PIEs**”), beyond just listed companies and other entities with securities traded on a regulated exchange.
 - **Resilience Statement**
 - Large PIEs will be required to produce a resilience statement in their strategic report, which reports on the company’s approach to risk management, including how risks and resilience issues – e.g. cybersecurity, supply chain resilience and business continuity – are being addressed over the short and medium term (as determined and justified by the board), together with an explanation of how they have arrived at their judgment of materiality.
 - New resilience statement will incorporate and include existing viability and going concern statements; and require a reverse stress testing scenario.
 - Directors will have a liability “safe harbour” under section 463 of the Companies Act 2006 if not reckless.
 - **Statement on Internal Controls**
 - The Government is expected to invite the FRC to strengthen the Code to provide an explicit directors’ statement about the effectiveness of a company’s internal controls and the basis for that assessment, but no “SOX-type” directors’ sign-off (for now). Large PIEs will need to state whether they are seeking any external assurance on the statement, and report on steps taken to prevent and detect material fraud.
 - **Dividends**
 - Large PIEs will be required to disclose their distributable reserves position and make an explicit statement confirming the legality of proposed dividends and any dividends paid during the year, together with an explanation as to the long-term approach to the amount and timing of shareholder returns (including dividends, share buybacks, etc.) and how this distribution policy has been applied in the reporting year.

Davis Polk



Connie I. Milonakis

Partner

+44 20 7418 1327

connie.milonakis@davispolk.com



Dan Hirschovits

Partner

+44 20 7418 1023

dan.hirschovits@davispolk.com



Maxim Van de moortel

Counsel

+44 20 7418 1446

maxim.vandemoortel@davispolk.com



Sophie Vacikar Bessisso

Associate

+44 20 7418 1093

sophie.vacikarbessisso@davispolk.com