Vinson&Elkins

TEN HOT TOPICS & ONE REMINDER:

DEVELOPMENTS IN GOVERNANCE AND DISCLOSURE

WINTER 2018

THE RISK ISSUE

1 TAKEAWAYS FROM THE SEC'S ROUNDTABLE AND OTHER NEW SEC RULES, GUIDANCE AND DEVELOPMENTS

On November 15, 2018, the SEC held a roundtable on the proxy process with three panels — the first panel addressed proxy voting mechanics and technology, the second addressed the SEC's existing rules and guidance regarding shareholder proposals, and the third panel addressed the role of proxy advisory firms and their relationships with institutional investors and issuers. The most lively discussion topic during the first panel related to which participants in the proxy process should take responsibility for correcting inaccuracies in the vote counting process. Various panelists described experiences with overvoting, undervoting, material delays in vote counting, and proxy disqualifications. The first panel also addressed the obstacles companies face in communicating with beneficial owners and the advisability of a universal proxy. As a reminder, a universal proxy is a single proxy card that includes both the board's director candidates and any director candidates nominated by shareholders. Despite failing to achieve any consensus or new ideas on ways to improve proxy voting mechanics, panelists appeared to agree that there is low hanging fruit the SEC can address with respect to voting accuracy and the full recognition of beneficial owner voting. These would include issuing guidance on voting confirmation and voting reconciliation and adopting final universal proxy rules.

At the second panel, the panelists debated whether the current ownership and resubmission thresholds for shareholder proposals submitted under Rule 14a-8 are appropriate or should be increased. Representatives of investors on the panel mostly supported the retention of the current thresholds, while public company representatives recommended increasing the ownership and resubmission thresholds, holding periods and proponent disclosures requirements.

The third panel was clearly the most anticipated going into the roundtable, but it failed to deliver any fireworks. In advance of the roundtable, the SEC **withdrew two letters** that arguably protected the positions of proxy advisory firms in the proxy process. The two letters issued in 2004 to ISS and Egan-Jones provided that an investment adviser could demonstrate the absence of a conflict of interest, and the fulfillment of fiduciary duties, by voting based on the recommendations of a proxy advisory firm, provided certain protections were in place. The withdrawal of these letters led to speculation that the SEC may be considering providing guidance on proxy advisory firms' influence on the proxy process, however, the withdrawal of the letters did not come up during the roundtable. During the panel, representatives from ISS and Glass Lewis defended their role as advisors, emphasizing that the ultimate voting decisions remain in the hands of investors. The ISS representative provided details on how the organization separates its consulting wing from its policy wing, and suggested that ISS always corrects errors (to the extent they are errors and not differences of opinion) that are brought to its attention. Ultimately, while the SEC's roundtable provided listeners with additional details on the various views of proxy process participants, governance practitioners will have to wait to see whether the Commission will choose to act on any of the covered topics.

In August 2018, the SEC* issued amendments *that simplified and updated duplicative, overlapping and outdated requirements. Specifically, the amendments eliminate certain: (a) redundant and duplicative requirements that require substantially similar disclosures as U.S. Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS), or other SEC disclosure requirements; (b) overlapping requirements that are related to, but not the same as GAAP, IFRS, or other SEC disclosure requirements; (c) outdated requirements that have become obsolete as a result of the passage of time or changes in the regulatory, business or technological environment; and (d) superseded requirements that are inconsistent with recent legislation, more recently updated SEC disclosure requirements, or more recently updated GAAP. These changes took effect on November 5, 2018. The amendments also added a new disclosure requirement — that quarterly reports on Form 10-Q must include information regarding changes in shareholders' equity and the amount of dividends per share for each class of shares. Disclosure of this information is already required in annual reports on Form 10-K. Calendar year companies are generally not required to comply with this new requirement before the Form 10-Q filed for the quarter ended March 31, 2019; companies with fiscal years other than the calendar year are not required to reflect the change until the quarter commencing after the effective date of the amendment (November 5, 2018).

HAVE YOU UPDATED YOUR FORMS 10-Q AND 10-K COVERS?

As a reminder, this past year the SEC amended the definition of small reporting companies (SRC), one effect of which was to modify the cover page of Forms 10-K and 10-Q as well as several other forms to remove the parenthetical next to the "non-accelerated filer" definition that states "(Do not check if a smaller reporting company)." Companies should check all applicable boxes on the cover page addressing, among other things, non-accelerated, accelerated, and large accelerated filer status, SRC status, and emerging growth company status.

The SEC recently* announced *it would begin releasing certain staff communications with issuers through EDGAR documentation. On October 1, 2018, the SEC began releasing through EDGAR orders the SEC issues granting or denying regulatory relief on behalf of the Commission.

In October 2018, the SEC launched its* Strategic Hub for Innovation and Financial Technology *(FinHub). FinHub is a resource for public engagement on the SEC's financial technology-related issues and initiatives, such as distributed ledger technology (including digital assets), automated investment advice, digital marketplace financing, and artificial intelligence/machine learning. FinHub also replaces and builds on the work of several internal working groups at the SEC that have focused on similar issues.

The SEC recently issued additional Rule 14a-8 guidance. On October 23, 2018, the SEC released Staff Legal Bulletin 14J (CF) (the "SLB"), which provides guidance on Rule 14a-8, the rule that permits shareholders to submit proposals for inclusion in a company's proxy statement. The new SLB focuses on the "economic relevance" exception under Rule 14a-8(i)(5) and the "ordinary business" exception under Rule 14a-8(i)(7). The SLB recommends that no-action requests that include a discussion of the board's analysis related to these exceptions describe in sufficient detail the specific substantive factors the board considered in evaluating a request, and provides a non-exhaustive list of the types of information companies may include. Significantly, the SLB provides that a proposal regarding senior executive and/or director compensation may be excludable under Rule 14a-8(i)(7) if (i) the proposal's underlying concern involves ordinary business matters that are not sufficiently related

to executive and/or director compensation or (ii) a primary aspect of the targeted compensation is broadly available or applicable to the company's general workforce. Further, a proposal addressing executive and/or director compensation may be excludable under the "micromanagement" argument where the proposal seeks intricate detail or seeks to impose specific timeframes or methods for implementing complex policies.

The SEC may be reconsidering quarterly reporting, again. The latest **SEC Agency Rule List** indicates that a proposal for semi-annual reporting is forthcoming; such a policy would put the United States in line with EU and UK reporting rules and could, in theory, result in lower reporting costs for companies. The proposal is still in the pre-rule stage, and the notice does not commit the SEC to adopt a policy change.

Upcoming V&E CLE: December 6, 2018

STRATEGIC PREPARATION FOR THE 2019 10-K AND PROXY SEASON

Join Broadridge and V&E governance professionals as we discuss the key trends and developments that will drive the 2019 annual report and proxy season, including:

- (i) recent SEC guidance and remarks, including takeaways from the SEC's Nov. 15 roundtable,
- (ii) changes in ISS, Glass Lewis and investors' proxy voting guidelines, and
- (iii) trends in ESG proposals and disclosures. We will also discuss common annual report and proxy statement errors, considerations for companies in transition, and how to effectively utilize your "off-season."

Featured Speakers:

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2 RECENT SEC ENFORCEMENT EFFORTS HIGHLIGHT EMERGING AREAS OF RISK

In September 2018, the SEC announced that SeaWorld Entertainment Inc. and its former CEO settled fraud charges for misleading investors about the impact of the documentary film* Blackfish *on the company's reputation and business. SeaWorld and its former CEO agreed to pay more than $5 million, and the company's former vice president of communications also agreed to settle a fraud charge, for their respective roles in misleading SeaWorld's investors. Steven Peikin, co-director of the SEC Enforcement Division, stated that "this case underscores the need for a company to provide investors with timely and accurate information that has an adverse impact on its business. SeaWorld described its reputation as one of its 'most important assets,' but it failed to evaluate and disclose the adverse impact *Blackfish* had on its business in a timely manner."

The SEC charged Voya Financial Advisors Inc. with deficient cybersecurity procedures. The SEC charged Voya with violating the Safeguards Rule and the Identity Theft Red Flags Rule, which are designed to protect confidential customer information and protect customers from the risk of identity theft. Voya agreed to settle charges in exchange for a $1 million penalty. According to the SEC's September 2018 order, Voya's failure to terminate intruders' access to its systems stemmed from weaknesses in the company's cybersecurity procedures, some of which had been exposed during similar fraudulent activity that had occurred previously. According to the order, Voya also failed to apply appropriate procedures to the systems used by its independent contractors.

Earlier this year, the SEC announced that the entity formerly known as Yahoo! had settled charges that it failed to disclose its cybersecurity breach. Yahoo! agreed to pay a $35 million penalty to settle the charges that it misled investors by failing to disclose one of the world's largest data breaches, in which hackers stole personal data relating to hundreds of millions of user accounts. Steven Peikin, co-director of the SEC Enforcement Division, stated that while the Division does "not second-guess good faith exercises of judgment about cyber-incident disclosure," it was clearly the case that the company's response to the event was "so lacking that an enforcement action [was] warranted."

THE AVERAGE TOTAL COST OF A DATA BREACH IS $3.86 MILLION.*

Build an **Incident Response Team** with members from **key corporate departments** to **act fast against a data breach:**

Information Technology | **Legal & Compliance** | **Business Management** | **Public Relations** | **Risk Management**

Companies that contained a breach in less than 30 days **saved over $1 million** compared to those that took longer to resolve.*

* Source: Ponemon Institute (2018). 2018 Cost of a Data Breach Study: Global Overview.

3 POTENTIAL REPERCUSSIONS GROW FOR BOARDS LACKING GENDER DIVERSITY

At an October 2018 investor conference, investor spokespeople indicated that board diversity is their major focus. In October 2018, the general counsel of the Council of Institutional Investors indicated that "diversity is really going to be a key area of engagement…[w]e're going to see that be a major area of focus, including gender diversity of boards." Ted Allen, vice president of Strategic Communications at the National Investor Relations Institute, said he agreed that board diversity would be a top issue for shareholder engagement in 2019.

The NY Comptroller is dedicated to increased activism regarding board diversity. The NY Comptroller has been focused on board diversity since 2017, and practitioners expect even greater involvement from the NY Comptroller in the 2019 proxy season on the issue of board diversity.

California has become the first state to require public companies to take board diversity seriously. California has adopted a law requiring public companies headquartered in California to include at least one woman on their boards by the end of 2019 and at least two to three women (depending on the size of the board) by the end of July 2021. The new law permits the California secretary of state to impose fines on noncomplying corporations.

Also, see "Top Investors Renew Their Commitments to ESG Engagement" (beginning on page 8) and "ISS and Glass Lewis Updates" (page 14).

Expanding Investor and Market Interest in Board Diversity: What Does It Mean?

Public companies with boards that lack gender diversity:

- Are likely to experience greater engagement on board composition in 2019 and beyond.
- Have a good chance of receiving a shareholder proposal on board diversity.
- May see Glass Lewis recommend against one or more of their directors for the company's 2019 annual meeting.
- May see ISS recommend against one or more of their directors for the company's 2020 annual meeting.

Most public companies:

- Are likely to experience enhanced investor interest in their board's composition in 2019.
- May receive investor requests or shareholder proposals for enhanced board composition disclosures, including board skills matrices.

4 TOP INVESTORS RENEW THEIR COMMITMENTS TO ESG ENGAGEMENT

AN EXPLOSION OF REGULATORY AND INVESTOR INTEREST IN ESG

2010:
SEC issues climate change disclosure guidance

2011:
SEC issues cybersecurity disclosure guidance

2012 - 2014:
SEC issues two reports to Congress on climate change disclosures

March:
BlackRock and State Street indicate they intend to hold directors responsible for a lack of diversity on their boards

August:
Vanguard issues its Investment Stewardship 2017 Annual Report, indicating that climate change and board diversity are priorities

State Street issues Perspectives on Effective Climate Change Disclosure

September:
NYC Comptroller announces "Boardroom Accountability Project 2.0" advocating for board diversity and board climate expertise

November:
New ISS and Glass Lewis policies address board diversity and climate change matters

2017

January:
BlackRock issues investor letter emphasizing the importance of corporate social responsibility

March:
BlackRock issues Investment Stewardship Engagement Priorities focused on ESG matters

February:
SEC issues updated cybersecurity disclosure guidance

ISS launches Environmental & Social QualityScore

April:
SEC brings first cyber-related disclosure enforcement action (Yahoo!)

NIST issues updated Framework for Improving Critical Infrastructure Cybersecurity

DOJ issues an interpretive bulletin regarding plan investments and ESG goals

July/August:
State Street issues Global Stewardship Report and Vanguard issues 2018 Investment Stewardship Report, each focused on ESG matters

October:
ISS issues FAQs on its new Environmental & Social QualityScore

2018

IN ADDITION, NON-U.S. REGULATORY DEVELOPMENTS ARE LIKELY TO BE MAJOR REGULATORY DRIVERS (E.G., EU DIRECTIVE ON NON-FINANCIAL DISCLOSURES).

Vanguard has reaffirmed its commitment to environmental and social governance (ESG) issues. As a reminder, Vanguard's 2017 Investment Stewardship Annual Report focused on board gender diversity, the firm's view on climate risk, and the firm's methods for engaging with companies.

On August 15, 2018, Vanguard released its **2018 Investment Stewardship Report**, which gives insight into the firm's approach to evaluating various ESG matters, including, for example, shareholder proposals requesting climate risk disclosure. Specifically, Vanguard notes that, in evaluating whether to vote for or against ESG shareholder proposals, it considers whether the disclosure is material to the company's long-term value, whether the company's existing disclosures are sufficient, and whether the company's public commitments or the proposal's request better reflects a long-term perspective. In its 2018 report, Vanguard demonstrated its approach by providing no-name examples of engagement with companies facing such proposals. These examples indicate that companies' attitudes towards a proposal and existing commitments are important factors in Vanguard's decision to support or oppose a proposal. Companies that thoughtfully considered shareholder proposals, rather than dismissing them as unimportant, and demonstrated a commitment to sustainability through their existing disclosures were viewed favorably by Vanguard, even if the proposal was not ultimately successful. Vanguard has issued **a guide** for companies that want to engage with the investor.

Vanguard also recently launched two new ESG index ETFs. Each ETF seeks to track one of two broad-based FTSE Russell indexes, one consisting of U.S. equities and the other consisting of international (non-U.S.) equities. These indexes are constructed to offer broad large-, mid- and small-capitalization equity exposure while excluding companies that do not meet certain ESG criteria.

VANGUARD'S ADVOCACY, ENGAGEMENT AND VOTING

- Discussed board composition in more than **50%** of our engagements, consistent with the 2017 proxy year.
- Saw fewer total proposals about gender diversity on boards as more companies make progress; voted in favor of **4** out of **9** gender diversity proposals.

- Discussed compensation in more than **50%** of our engagements.
- Voted against **318** members of company board compensation committees for failing to act in response to shareholder feedback.

- Engaged with **over 200** companies in carbon-intensive industries. Supported **11** out of **76** environmental disclosure proposals, compared with **2** out of **92** in 2017.
- Engaged with **3** publicly owned gun manufacturers and supported **1** shareholder proposal calling for greater risk disclosure. Also engaged with **8** drug manufacturers, drug distributors, and pharmaceutical companies about the opioid epidemic and its impact on their business.

* https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf.

State Street is holding directors accountable for a lack of gender diversity on the board and has identified climate change and water management as important themes going forward. Last year, State Street issued a policy that it will consider voting against the chair and other members of a board's nominating and/or governance committee if a company fails to take action to increase the number of women on the board; the policy identified boards with no female representation or less than 15% female representation as problematic. To date, the investor has voted against the reelection of directors at over 500 companies on grounds that they had failed to add women to their boards.

In July 2018, State Street released its annual **Global Stewardship Report** for the 2017 fiscal year, which outlined the investor's approach to proxy voting and engagement and thematic priorities. The report provides additional details on State Street's commitment to gender diversity on boards, stating that beginning in 2018, the investor "expect[s] that [its] portfolio companies monitor and disclose the level of gender diversity not only on their boards but at all levels of management." For the 2019 proxy season, practitioners expect State Street to continue to vote against specific directors where their boards lack gender diversity, and beginning in 2020, State Street will vote against the entire nominating committee if a company does not have at least one woman on its board and has not engaged successfully with State Street for three consecutive years.

State Street also is focused on climate change and water management as important themes for the upcoming year. In its report, State Street reaffirms its expectation for both high quality climate change disclosures, as outlined in its 2017 guidance on **Effective Climate Change Disclosure**, and integration of climate risk into companies' long-term strategies. State Street slated scenario testing and portfolio resilience, technological investment, emissions management strategies, and public policy engagement as additional climate-related topics for engagement. Based on the report, State Street will expand its climate-risk focus to more sectors, including agriculture, transportation, and insurance. The investor also plans to look at the entire lifecycle of a company, including the carbon intensity of upstream and downstream operations.

BlackRock is devoted to reviewing companies' ESG commitments and expects at least two women on the boards of companies in which they invest. BlackRock's **2018 Investment Stewardship Engagement Priorities** reminded companies that BlackRock is focused on disclosures that "fully inform" their assessment of "quality governance, including the exposure to and management of environmental and social factors." BlackRock touched on its recent approach to engagement on climate risk, which encourages companies to follow the Financial Stability Board's Task Force on Climate-related Financial Disclosures' recommendation for climate risk disclosures in four categories: (1) governance, (2) strategy, (3) risk management, and (4) metrics and targets. BlackRock also indicated that it would begin holding boards accountable for a lack of board diversity. In its February **2018 proxy voting guidelines**, BlackRock clarified that it normally expects to see at least two female directors on every board.

5 CALLS FOR ESG LEGISLATION, REGULATION AND GUIDANCE INCREASE

In October 2018, a petition calling for greater ESG disclosure requirements was filed with the SEC by a group of investors, state treasurers, public pension funds and unions representing more than $5 trillion in assets under management. In particular, the petition discusses the implications of requiring disclosure regarding climate risks and opportunities, short- and long-term sustainability risks, gender pay equity, human capital management, human rights, political spending disclosure and international tax strategies.

In September 2018, California adopted a law requiring CalPERS and CalSTERS to review and report on climate-related financial risks that are material to the stability of their portfolios. It is possible that the rule will have limited immediate effect, as the rule permits the pension funds' boards to only disclose climate risks if doing so is in the best interest of their shareholders, and CalPERS and CalSTERS already have robust climate risk programs, and both indicated that they are committed to improving their climate risk profiles. However, in October 2018, CalPERS experienced a leadership shift, which may result in a shift in the fund's commitment to ESG matters, particularly given that the fund's new leadership has suggested that the fund has been too focused on ESG matters in the past.

***In September 2018, Senator Warren introduced* The Climate Risk Disclosure Act.** On September 14, 2018, Senator Elizabeth Warren introduced a bill to mandate disclosure of climate risk in SEC filings. If enacted, The Climate Risk Disclosure Act would require each company to disclose (i) its direct and indirect greenhouse gas emissions, (ii) the total amount of fossil-fuel related assets that it owns or manages, (iii) how its valuation would change if climate change continues at its current pace or if policymakers successfully restrict greenhouse gas emissions to meet the Paris Agreement goal, and (iv) its risk management strategies related to the physical risks and transition risks posed by climate change. The Act would also direct the SEC to issue disclosure rules tailored to different industries and require additional disclosure from companies involved in fossil fuel development. Supporters of the legislation believe it is a necessary step to ensure that investors have adequate information about how companies are planning for a transition to a lower carbon economy. While the bill appears unlikely to gain traction, it reflects a growing push for increased environmental disclosures.

Upcoming V&E CLE: December 12, 2018

THE NEW GOVERNANCE: NAVIGATING THE RISING ESG TIDE

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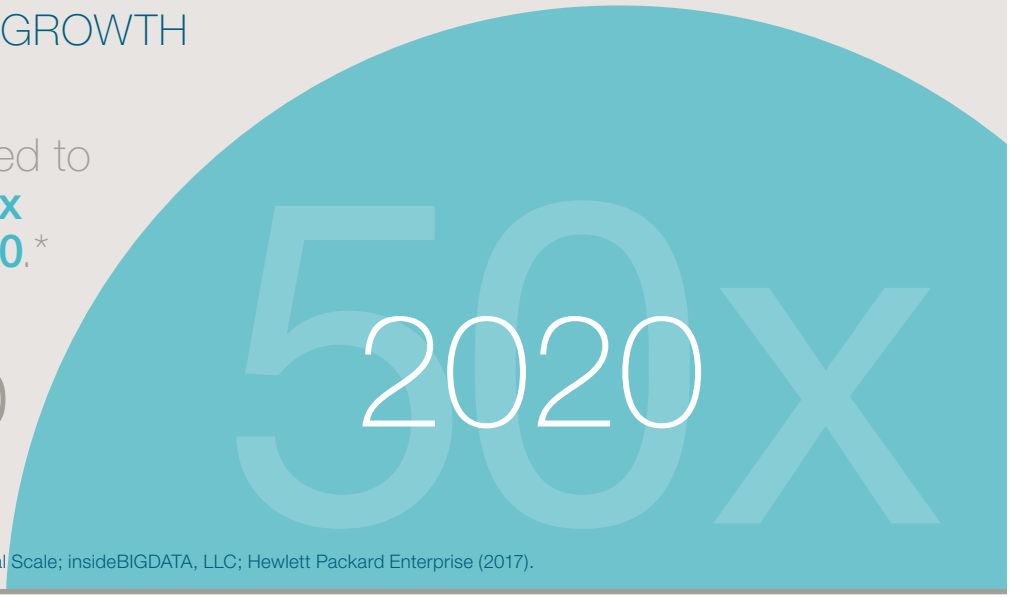
6 THE SEC REMAINS FOCUSED ON CYBER CONTROLS

The SEC Division of Enforcement, Division of Corporation Finance and the Office of Chief Accountant issued a Report of Investigation regarding certain cyber-related frauds. On October 16, 2018, the SEC issued a report focusing on whether certain public companies that were victims of cyber-related frauds may have violated the federal securities laws by failing to have sufficient internal accounting controls. The report describes the SEC Enforcement Division's investigations of nine public companies that lost millions as a result of cyber fraud. While the report does not announce any action against those companies, it does clarify that the Enforcement Division will continue to analyze how public companies create and implement internal controls relating to cybersecurity. The SEC's release indicates that "[w]hile…cyber-related threats posed to issuers' assets are relatively new, the expectation that issuers will have sufficient internal controls and that those controls will be reviewed and updated as circumstances warrant is not."

In recent speeches, SEC Commissioners have stressed the importance of cyber oversight. In **a recent speech**, Commissioner Jackson focused on the rising cyber threat, stating that "the cyber threat is a corporate governance issue," and that a company that effectively manages cyber risk will have cyber expertise at every level (including in the board room). Commissioner Jackson called upon the Commission to consider requiring Form 8-K disclosure for cyber events, insider trading considerations and internal controls. With respect to internal controls, Commissioner Jackson suggested that companies need to build "the internal reporting structure that will help boards and management better anticipate, assess, and, where necessary, disclose the next significant cyber attack." In another **recent speech**, Commissioner Stein suggested that the Commission's recent cyber guidance fell short, and that the Commission should "lead by helping to create standards for disclosure, using structured data and taxonomies, where applicable."

THE EXPONENTIAL GROWTH OF TOTAL DATA

Total data is expected to **increase by 50x** from **2010 to 2020**.*



* The Intelligent Use of Big Data on an Industrial Scale; insideBIGDATA, LLC; Hewlett Packard Enterprise (2017).

7 CYBER SNAPSHOT: CALIFORNIA'S "GDPR"

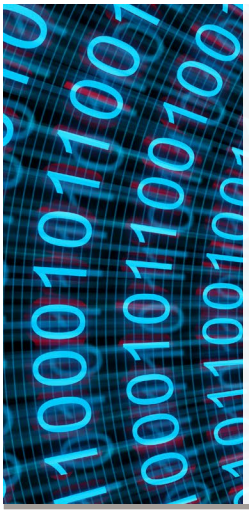
The California Consumer Privacy Act ("CCPA"), which gives California residents rights similar to those provided in the EU General Data Protection Regulation ("GDPR"), was recently passed by the California legislature and takes effect on January 1, 2020. California already has laws reflecting privacy as an "inalienable" right under its constitution, but as discussed in greater detail in our **July 2018 article**, the CCPA takes existing California privacy law even further. California **Senate Bill No. 1121** ("SB 1121"), approved on September 23, 2018, amends the CCPA to provide some clarity into a company's compliance obligations under the CCPA.

a. **The CCPA protects the "personal information" of "consumers."** The definition of "consumer" includes employees, contractors, patients, and any other natural person that is a California resident. "Personal information" is broadly defined to include characteristics and behaviors, personal and commercial, as well as inferences drawn from the information collected to create a consumer profile.

b. **The CCPA affects more U.S.-based businesses than the GDPR.** The CCPA applies to any for-profit business that collects consumers' personal information and satisfies one or more of the following: (1) holds $25 million in revenue, (2) holds the personal information of at least 50,000 consumers, or (3) derives at least 50% of its annual revenue from selling consumers' personal information.

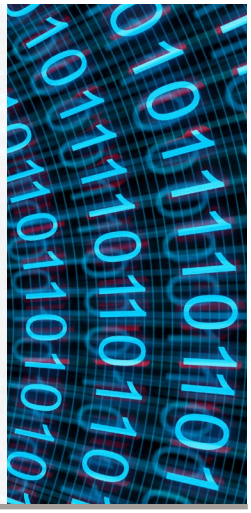
c. **Civil penalties may be imposed for noncompliance.** Any person, business or service provider that intentionally violates the CCPA may be liable for a civil penalty of up to $7,500 for each violation. SB 1121 delays enforcement actions, which gives companies a brief window to implement technical and administrative measures that will enable compliance. Companies should examine whether the CCPA applies and adjust their data protection practices accordingly.

Other states, or the federal government, may follow with their own data privacy laws. Amid growing support for a national policy, the Senate Commerce, Science, and Transportation Committee heard testimony on October 10, 2018 covering the GDPR and the CCPA. Committee Chairman John Thune (R-SD) stated that industry self-regulation is not sufficient and rules establishing a national privacy standard are needed.



"Vinson & Elkins lawyers provide excellent client service and are critical members of our team. They are unwaveringly focused on meeting our needs in a timely manner."

– Chambers USA 2018



8 THE IRS BEGINS THE TASK OF ADDRESSING SECTION 162(M) CHANGES

In August 2018, the IRS provided initial guidance on new Section 162(m). As a reminder, as amended, Section 162(m) of the tax code disallows a deduction by any publicly held corporation for employee remuneration paid to any covered employee to the extent that the employee's remuneration for the tax year exceeds $1 million. The amendments to Section 162(m) changed the definition of covered employees, broadened which publicly held corporations are subject to the provision, and eliminated the "performance-based" compensation exception to the $1 million limit. The amendments also contained a grandfather rule allowing employment arrangements entered into prior to the amendments to be governed by the old version of Section 162(m). The IRS recently issued **Notice 2018-68**, which provides guidance on the definition of a "covered employee" and the operation of the grandfather rule, including how to determine whether a contract is a written binding contract and whether a contract has been materially modified. The IRS also indicated that Notice 2018-68 is interim guidance and that it plans to issue regulations interpreting new Section 162(m).

9 ISS AND GLASS LEWIS UPDATES

Earlier this year, ISS launched its new Environmental & Social Disclosure QualityScore, which scores companies on their level of ESG disclosures across eight broad categories, and recently ISS issued several new policies and FAQs for 2019. This past summer, ISS released its annual policy survey, which included questions on auditor ratification, director accountability, gender diversity, voting rights and board qualification disclosure. On November 19, 2018, ISS issued its new draft policies for 2019, which for the U.S. include a policy on board diversity and a policy addressing the advisor's pay-for-performance model. The board diversity policy states that, for meetings on or after February 1, 2020, ISS will recommend against the chair of the nominating committee (or other directors responsible for board nominations on a case-by-case basis) at companies with no female directors on the board, subject to certain mitigating factors. On November 21, 2018, ISS issued preliminary FAQs on its compensation policies for 2019, which, among other matters, address the non-employee director compensation policy and the equity plan scorecard change in control vesting factor.

In October 2018, Glass Lewis released its updated policies, which for the U.S. address board diversity, environmental and social risk oversight and various other matters and include a few updates to compensation-related policies. Glass Lewis also announced that it will integrate ESG topics from the Sustainability Accounting Standards Board into Glass Lewis' research reports and voting recommendations platform.

10 COMPLIANCE SNAPSHOT: NEW "GIFT" RULES FOR AEROSPACE AND DEFENSE

Industry Group Issues New Hospitality and Gift Guidelines for Aerospace and Defense
By William Lawler and Sarah Tishler

In October 2018, the International Forum on Business Ethical Conduct ("IFBEC") published guidelines for its aerospace and defense members on business courtesies and hospitality. IFBEC is a nonprofit organization, founded in 2010 by member companies of the Aerospace Industries Association of America, and the AeroSpace and Defence Industries Association of Europe, and now counts aerospace and defense companies around the world as its members. IFBEC has previously published broader guidelines for its members, including the Global Principles of Business Ethics for the AeroSpace and Defence Industry.

IFBEC's Model Business Courtesies and Hospitality Guidelines (the "Guidelines") focus on hospitality and gifts. These can take the form of modest gifts, meals and/or refreshments, lodging, invitations to business events, travel costs, and entertainment. These "common tokens of appreciation" are generally allowed, as long as they are "lawful and infrequent," are not made with the objective of "giving or obtaining a favor, or any undue advantage," "advance a legitimate business purpose," do not pose or create a conflict of interest, and are made transparently. The Guidelines also unequivocally state that cash payments are always prohibited. The Guidelines center on the "4R Rule":

1. **Comply with the Regulations.** Offer only business courtesies and hospitality that comply with applicable law and the internal policy of the receiving organization.

2. **Be Reasonable.** Business courtesies and hospitality should be "limited and reasonable for the circumstances." Any that "may be viewed as extravagant" or that are of questionable appropriateness should be avoided all together. The Guidelines provide the example of marketing or promotional items of "modest" value that bear the logo of the offering organization.

3. **Be Responsible.** IFBEC members are expected to use "common sense, experience and professionalism" in evaluating any unique situation implicating business courtesies or hospitality, and suggest using the "newspaper" test – if the business courtesies or hospitality in question were the subject of a publication in local and international press, would that damage the reputation of the offeror, the recipient, and/or their respective organizations?

4. **Keep Records.** Members offering business courtesies and hospitality must keep accurate, transparent records. The Guidelines suggest including the name of the employee offering, the name of the recipient, the business purpose, the date the item was offered, and the description of the item, along with its approximate value. Additionally, all necessary approvals should be documented and retained as part of the record.

The Guidelines are in close alignment with existing guidance in the United States Department of Justice's and the United States Securities and Exchange Commission's November 2012, A Resource Guide to the U.S. Foreign Corrupt Practices Act, (the "Resource Guide"). The Resource Guide notes that the "hallmarks" of appropriate gifts and business courtesies are gifts "given openly and transparently, properly recorded in the giver's books and records, provided only to reflect esteem or gratitude, and permitted under local law." Modest promotional gifts, meals, and travel to and from a trade show provided by an organization to foreign officials given openly and recorded transparently are proper. A $12,000 birthday trip for a government official, including dinners and visits to vineyards would not be. The Resource Guide also notes that for larger companies, it is often prudent to have automated gift-giving clearance processes, with clear monetary limits for gifts, along with annual limitations. The Resource Guide states that gift-giving is not prohibited by the FCPA; what is prohibited is the payment of bribes, "including those disguised as gifts."

Aerospace and defense companies with existing robust FCPA compliance programs should already be in alignment with IFBEC's new Guidelines. Even without breaking any new ground, however, the IFBEC's guidelines serve as a reminder that gifts and hospitality continue to be a focus of enforcement and a high risk area for companies in all industries.

Upcoming V&E CLE: January 30, 2019

BUILDING AND OVERSEEING EFFECTIVE COMPLIANCE AND CORPORATE GOVERNANCE

Join V&E professionals as we discuss key trends and developments in compliance and corporate governance and how to create and oversee a healthy and holistic compliance and corporate governance program. This program will include updates on global enforcement and regulatory developments, and practical recommendations for addressing key areas of compliance and corporate governance risk and expanding stakeholder expectations regarding compliance and corporate governance matters.

Featured Speakers:

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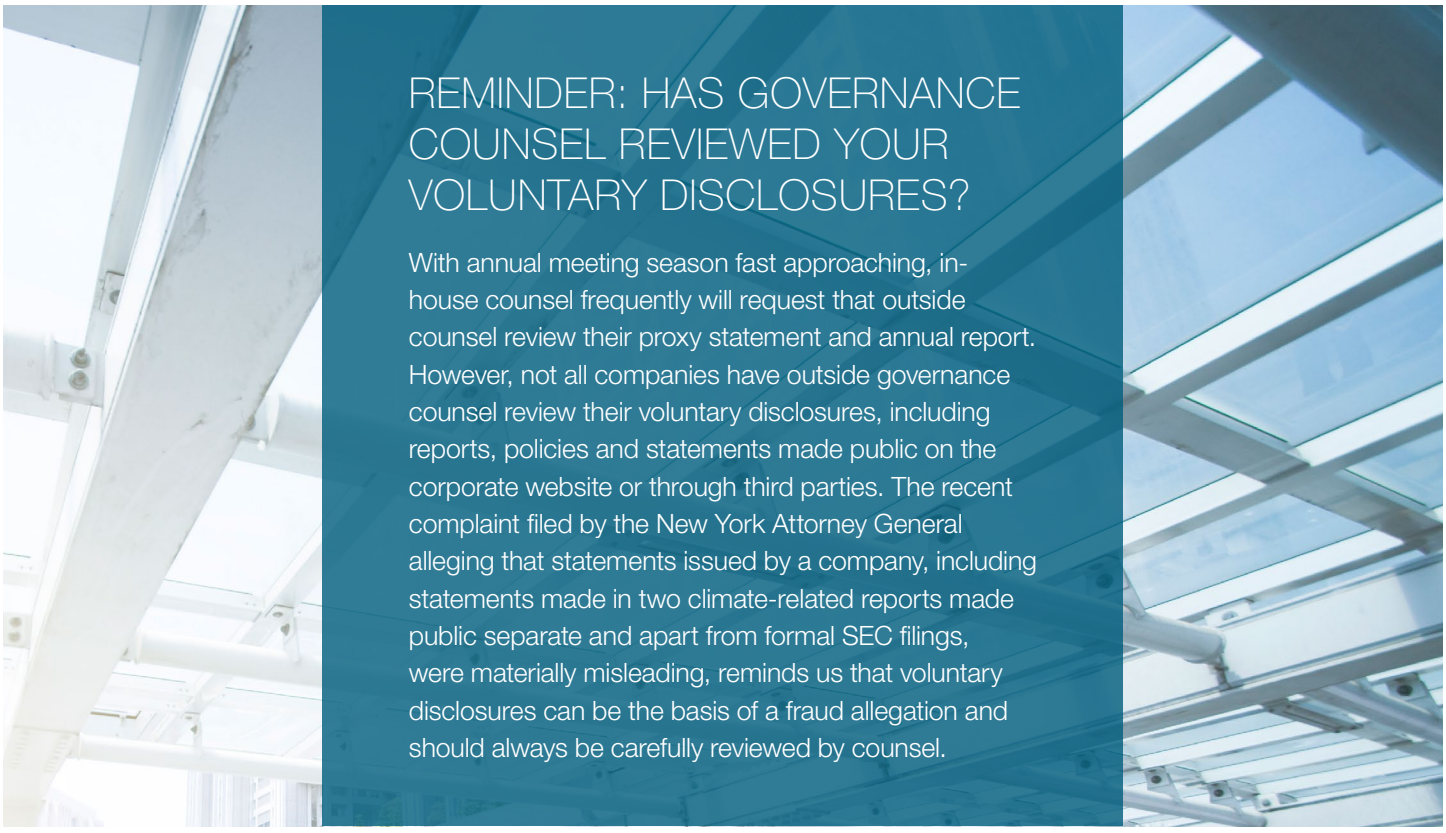

REMINDER: HAS GOVERNANCE COUNSEL REVIEWED YOUR VOLUNTARY DISCLOSURES?

With annual meeting season fast approaching, in-house counsel frequently will request that outside counsel review their proxy statement and annual report. However, not all companies have outside governance counsel review their voluntary disclosures, including reports, policies and statements made public on the corporate website or through third parties. The recent complaint filed by the New York Attorney General alleging that statements issued by a company, including statements made in two climate-related reports made public separate and apart from formal SEC filings, were materially misleading, reminds us that voluntary disclosures can be the basis of a fraud allegation and should always be carefully reviewed by counsel.

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