

## SEC Chair Highlights Disclosure Topics for Upcoming Filings

December 20, 2018

In a recent [speech](#), SEC Chair Jay Clayton highlighted three areas of disclosure that the regulator plans to monitor in the upcoming Form 10-K filing season, when companies take a close look at their risk factors: (1) the impact of Brexit, the United Kingdom's looming exit from the European Union, (2) the phase-out of the interest-rate benchmark LIBOR in debt instruments and other financial contracts and (3) cybersecurity risks.

- **Impact of Brexit:** The SEC is increasingly focused on the potential impact of Brexit on public companies. In Chair Clayton's view, the possible impact of Brexit has been understated. The UK's withdrawal from the EU is scheduled to become effective on March 29, 2019. There is still uncertainty as to whether the withdrawal agreement reached with the EU, or a variation thereof, will be approved by the UK parliament, or if a so-called "no-deal Brexit," whereby the UK leaves the EU without a ratified withdrawal agreement in place, will occur on March 29, 2019. In a no-deal scenario, the UK would become a "third country" in EU law. This could create major disruption for citizens and businesses in the remaining 27 EU member states (EU27) and the UK, and would have implications in a number of areas including trade, customs, financial services, air transport and climate policy. Many consider this option the worst possible outcome, and likely to have significant negative impact on both the UK's and the EU's economy. At present, both the UK and European Commission are intensifying preparations for a potential no-deal Brexit. In addition, even if the withdrawal agreement is approved by the UK parliament, its specific implementation as well as the future relationship between the UK and the EU following an agreed transition period also remain uncertain.

In crafting disclosure, a company should avoid making only general statements about the risk of Brexit to cross-border business and should instead focus on disclosure that is specifically tailored to the company. Any disclosure may need to be reviewed again closer to March 29, 2019, depending on the outcome of the UK/EU negotiations. Companies may want to explore such topics as:

- How management is considering Brexit and what steps are already underway or being contemplated by the company to operate through a range of possible Brexit outcomes?
- To what extent do the company's supply chains pass through the UK or the EU, and how would disruption in those supply chains impact the company's ability to manufacture and meet contractual obligations?
- Does the company have a material physical presence in the UK whose ability to operate smoothly through and after March 29, 2019 could be impacted?
- Does the company have key or significant numbers of UK or EU-based employees who may want or need to clarify or change their immigration status?
- Does the company have significant cross-border contractual arrangements in place that might need to be renegotiated as a result of Brexit, for example, to reflect that they adequately clarify the terms for trade across EU borders?
- Are any of the company's financial counterparties UK-based and is there any risk that communications or operational difficulties during the transition could interfere with the performance of contractual obligations?

- Is the company subject to any UK or EU regulatory schemes that might change or is it required to obtain new licenses, registrations or other authorizations under a post-Brexit scenario that could have a material impact on the company?
- **Transition From LIBOR:** The transition from LIBOR as an interest rate benchmark, anticipated to take place in 2021 following the cessation of the reporting of information used to set LIBOR, is another risk that the SEC is focused on. Companies may want to explore such topics as:
  - What assets, liabilities or other financial products does the company have that are LIBOR-based and do these mature in 2021 or later?
  - Do LIBOR-based products already contain backstop language that will kick in if LIBOR is eliminated and what risks are there to the enforceability of such backstop language? What will be the impact on the company's cost of funds under potential alternative reference rates, including SOFR?
  - Where LIBOR-based products do not already contain backstop language that explains what happens if LIBOR is no longer available, can these products be renegotiated? If they cannot be renegotiated, what is the impact of uncertainty over the interest rate, and what contractual remedies may the parties to the obligations possess?
  - What will be the implications under any swap arrangements? Will hedges still be matched?
  - Will the company, if necessary, be able to develop and/or transition its risk management related financial models from LIBOR-based products to those based on one or more alternative reference rates, including SOFR, in a timely manner given their limited history?
  - Whether any inquiries have been made by regulators regarding the company's preparations and readiness for the transition from LIBOR?

Similar questions should be explored by lenders, debtholders and other companies with LIBOR-based assets.

- **Cybersecurity Risks:** The SEC will continue to focus on the disclosure of material cybersecurity risks and incidents. As we discussed in a previous [memo](#), earlier this year the SEC's Division of Corporation Finance issued interpretive [guidance](#) calling for disclosure if a cybersecurity risk could materially impact a company's operations. In addition to disclosure, Chair Clayton emphasized the importance of having adequate disclosure controls and procedures that would allow for timely disclosure of material cybersecurity events, and securities trading policies to prevent insiders from trading prior to such disclosure. Companies may want to explore such topics as:
  - To what extent do the company's databases contain personally identifiable information about consumers or other data that is particularly susceptible to misuse?
  - How is the board monitoring cybersecurity as part of the company's risk management? Does the board have an independent member with expertise in technology and cybersecurity?
  - What controls are in place to ensure that appropriate persons at the company are notified of material cyber breaches so that such breaches are disclosed in a timely manner?

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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