7 April 2022

SEC in Focus

Quarterly summary of current SEC activities

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SEC proposes climate-related disclosure requirements

The Securities and Exchange Commission (SEC) proposed new **rules** to enhance and standardize disclosures that registrants make about climate-related risks, their climate-related targets and goals, their greenhouse gas (GHG) emissions, and how the board of directors and management oversee climate-related risks. The proposal would also require registrants to quantify the effects of certain climate-related events and transition activities in their audited financial statements.

In a statement, SEC Chair Gary Gensler said the proposed rules would provide investors with consistent, comparable and decision-useful information and would provide registrants with a consistent and clear framework for reporting. The proposing release said climate disclosures are "fundamental" to investors' understanding of a registrant's business and prospects and, therefore, need to be provided in a new "Climate-Related Disclosures" section of registration statements and annual reports, though they could be incorporated by reference from other parts of the reports (e.g., risk factors).

The proposal draws on the framework developed by the Task Force on Climate-related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol that are already starting to be used around the world. All registrants would be required to disclose Scope 1 and Scope 2 GHG emissions, which are defined as direct emissions and emissions resulting from the generation of electricity purchased and consumed by the company, respectively. Registrants that are not smaller reporting companies would be required to disclose Scope 3 emissions (i.e., all other indirect emissions) when material.

Registrants would also be required to disclose information about climate-related risks that have or are reasonably likely to have material impacts to their business or financial statements. The proposal would phase in the requirement for accelerated and large accelerated filers to obtain assurance over their Scope 1 and Scope 2 emissions data.

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- *To the Point,* ***SEC proposes enhancing and standardizing climate-related disclosures***
- *Tech Line,* ***Accounting and reporting considerations for the war in Ukraine***

In a new note to the audited financial statements, registrants would have to quantify and describe the effects of climate-related events and transition activities on individual line items above a certain threshold and disclose the impact of climate-related events and transition activities on estimates and assumptions used in preparing the financial statements. The proposal would affect all registrants, including smaller reporting companies and foreign private issuers.

The compliance date would depend on a registrant's filer status and would be phased in, beginning with fiscal year 2023, assuming the rules are adopted timely.

Comments are due at the later of 30 days after publication of the proposal in the Federal Register or 20 May 2022.

How we see it

The proposal would appear to apply to companies, including emerging growth companies, that are entering the US capital markets for the first time by conducting initial public offerings or as acquisition targets of public companies in a Form S-4. It also would not provide relief for recently acquired companies, which means registrants would need to include those operations in their disclosures upon consolidation.

SEC reporting considerations for the war in Ukraine

The ramifications of the war in Ukraine and the sanctions on Russia are far reaching and affect global trade and capital markets, in addition to companies' operations and risk management activities. The war and its ripple effects are also impacting people and operations not only in Russia and Ukraine but in many other countries. Most companies likely have limited direct exposure to the Russian and Ukrainian economies, but the indirect effects could have a meaningful impact on accounting and reporting matters. The impact will vary by company, and management will need to consider the company's facts and circumstances.

Domestic and foreign companies that file with the SEC need to consider a number of SEC reporting and disclosure requirements. They also need to make sure their disclosure controls and procedures are operating effectively so they can produce the necessary robust disclosures in a timely manner.

MD&A — Companies should disclose any unusual or infrequent events, transactions or significant economic changes that materially affected income from continuing operations (such as lost revenue or costs attributable to the war) in management's discussion and analysis (MD&A). They are also required to disclose known trends or uncertainties that have had, or are reasonably expected to have, a material effect on their revenue or income from continuing operations, liquidity or capital resources. It may also be appropriate for companies to include disclosures in MD&A related to any heightened uncertainty associated with key assumptions underlying critical accounting estimates.

Form 8-K — Affected companies should timely identify any triggering events that may warrant the filing of a Form 8-K. For example, a company will need to consider whether any physical damage, curtailment of operations in Ukraine or Russia or a decline in economic activity triggers a material impairment charge, which generally would require reporting within four business days under Item 2.06 of Form 8-K, unless the conclusion is made in connection with the preparation, review or audit of financial statements required to be included in a timely filing, and such disclosure is included in the timely filed report.

Risk factor disclosures — Since companies are required to disclose in each quarterly report on Form 10-Q any material new risks or changes in risk factors previously disclosed in its annual report on Form 10-K, companies should consider the need to update their risk factor disclosures to reflect the direct and indirect effects of the war.

Non-GAAP financial measures — Companies should be mindful of the SEC's rules, regulations and guidance when non-GAAP financial measures adjust for any items related to the conflict. We believe that registrants that want to explain any discrete effects should limit adjustments in their non-GAAP measures to charges incurred or gains recognized that clearly relate to the discrete event. It would generally be inappropriate to disclose a non-GAAP measure of operating performance that normalizes operations or eliminates normal recurring cash operating expenses.

Other SEC rulemaking and staff initiatives

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- *To the Point, **SEC proposes requiring more cybersecurity disclosures***
- *To the Point, **SEC proposes new SPAC disclosures and expanded liability for parties in SPAC transactions***

SEC proposes requiring cybersecurity disclosures

The SEC **proposed** new rules to enhance and standardize disclosures that registrants make about cybersecurity incidents and their cybersecurity risk management, strategy and governance.

The proposed rules would require registrants to disclose information about a material cybersecurity incident on Form 8-K within four business days of determining that the incident is material. Registrants would also have to provide updated disclosures in periodic reports about previously reported incidents, describe their policies and procedures, if any, for the identification and management of risks from cybersecurity threats, and provide disclosures about the board's oversight of cybersecurity risk and management's role in assessing and managing this risk and in implementing cybersecurity policies. In addition, they would have to disclose whether they have cybersecurity expert(s) on the board of directors and, if so, provide their name(s) and a description of their experience.

The proposal would apply to nearly all registrants that are required to file periodic reports (e.g., Form 10-K, Form 20-F) with the SEC, including smaller reporting companies and foreign private issuers.

How we see it

The SEC issued an Interpretive Release in 2018 that said registrants had an obligation to use Form 8-K to disclose information about material incidents. The proposal would formalize the timing and specify the content and location of cybersecurity incident disclosure, but the use of materiality as the threshold for providing disclosure would not change.

Separately, the SEC **proposed** new rules and amendments to enhance cybersecurity preparedness and improve the resilience of registered investment advisers, registered investment companies and business development companies against cybersecurity threats and attacks.

SEC proposes new SPAC disclosures and expanded liability for parties in SPAC transactions

The SEC **proposed** requiring new disclosures when a special purpose acquisition company (SPAC) conducts an initial public offering (IPO) and when it combines with a private operating company in what is known as a "de-SPAC transaction." The proposal would also subject SPACs, underwriters and their private company targets to liability under the securities laws. The proposal is intended to more closely align the disclosure requirements and legal obligations of parties involved in de-SPAC transactions with those in traditional IPOs. The proposed rules would, among other things:

- Require a SPAC to disclose the role of its sponsor, conflicts of interest, dilution and the fairness of the transaction in which it takes a private operating company public
- Amend the definition of a "blank check company" so the safe harbor from liability for forward-looking statements would not be available to SPACs
- Deem SPAC targets to be co-registrants and underwriters of SPAC IPOs to be underwriters of SPAC business combinations in certain situations, subjecting them to liability for untrue material statements or material omissions

- Codify existing staff views to align financial statement requirements in SPAC transactions with those of traditional IPOs
- Expand disclosures about projections of future performance, including whether they are based on historical results, the material assumptions used and whether the projections still reflect the view of the entity that prepared them

Statement on materiality evaluations of error corrections

SEC Acting Chief Accountant Paul Munter issued a **statement** saying that the staff continues to focus on registrants' evaluation of whether an error in previously issued financial statements is material and how the error should be corrected.

Mr. Munter said in the statement that it is important for registrants, auditors and audit committees to apply a well-reasoned, holistic and objective approach that includes consideration of both qualitative and quantitative factors when they assess whether an error is material.

> "We believe, however, that as the quantitative magnitude of the error increases, it becomes increasingly difficult for qualitative factors to overcome the quantitative significance of the error."
>
> — Acting Chief Accountant, Paul Munter

He noted that the SEC staff has challenged registrants' overreliance on qualitative factors to conclude that a quantitatively significant error is immaterial. He also highlighted aspects of materiality analyses to which the SEC staff has taken exception, including arguments that certain GAAP financial statements or line items are irrelevant to a particular registrant's investors or that a similar error was made by multiple registrants.

Mr. Munter also noted that the evaluation of the severity of a control deficiency should not be limited to the actual error and must consider the magnitude of the potential misstatement that could result from a control deficiency.

SEC staff issues SAB on accounting by crypto platforms

The SEC staff issued **Staff Accounting Bulletin (SAB) 121** to provide the staff's views regarding the accounting by entities that have obligations to safeguard crypto assets they hold for platform users.

The staff said it believes these entities should reflect this obligation as a liability on their balance sheet that should be measured at the fair value of the crypto assets they are responsible for holding. The staff said it would also be appropriate for these entities to recognize an asset equal to the fair value of the crypto assets they are responsible for safeguarding at the same time. The SAB also discusses disclosures the staff expects these entities to make and the staff's expectations for when an entity should apply the SAB.

SEC reopens comment period on its 'pay versus performance' proposal

The SEC reopened the comment period on its 2015 proposal that would require companies to disclose the relationship between executive compensation actually paid and total shareholder return for up to five years in proxy or information statements in which executive compensation disclosures are required.

The SEC also is now considering whether to require registrants to disclose additional performance measures, including pre-tax net income, net income and a measure selected by the company, as well as a list of a company's five most important performance measures, in order of importance.

The SEC sought comments on the proposed rules, which were mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, and questions raised in its reopening release.

Proposals aimed at enhancing private fund investor protection

The SEC proposed rules and rule amendments under the Investment Advisers Act of 1940 aimed at enhancing investor protection by requiring private funds to be more transparent about the cost of investing and fund performance and prohibiting certain activities, such as providing preferential terms to certain investors.

Under the proposal, SEC-registered private fund advisers would have to provide investors with quarterly statements detailing information about private fund performance, fees and expenses. Among other things, these advisers would have to obtain for each private fund an annual audit and an audit upon liquidation.

Separately, the SEC **proposed** requiring certain registered investment advisers to private funds to confidentially report to the SEC within one business day of the occurrence of certain events indicating significant stress at a fund that could harm investors or events signaling risk in the broader financial system.

The proposed amendments would also provide the SEC and the Financial Stability Oversight Council with more timely information to analyze and assess risks to investors and the markets more broadly by requiring large private equity advisers to provide more details on the private equity funds they manage than they currently do.

Proposed amendments aimed at modernizing beneficial ownership reporting

The SEC proposed **amendments** to Regulation 13D-G that would accelerate the filing deadlines for beneficial ownership reports from 10 days to five days and require amendments to be filed within one business day.

In addition, the proposal would expand the application of Regulation 13D-G to certain derivative securities, clarify the circumstance under which two or more persons have formed a "group" subject to beneficial ownership reporting and require beneficial ownership reports be filed using a structured, machine-readable data language (e.g., Inline XBRL).

Proposed amendments to whistleblower program rules

The SEC proposed two **amendments** to the rules governing its whistleblower program to further incentivize individuals to provide original information that leads to successful SEC enforcement actions.

One proposed amendment would allow the SEC to reward a whistleblower for an action that may otherwise be covered by another, non-SEC whistleblower program. The other would affirm the SEC's authority to consider the dollar amount of a potential award for the limited purpose of increasing it but not lowering it.

US GAAP and SEC reporting taxonomies

The 2022 US GAAP financial reporting taxonomy (GRT) and the 2022 SEC reporting taxonomy (SRT) for XBRL reporting have been **accepted** by the SEC and released for public use. The SEC staff strongly encourages companies to use the most recent version of the respective taxonomy for their submissions to take advantage of the most up-to-date tags.

The 2022 GRT contains updates for new accounting standards and other improvements since last year, including changes in elements related to credit losses, balance sheet offsetting, and pledge and recourse reporting. The 2022 SRT updates primarily relate to changes in elements for financial schedules required by the SEC and condensed consolidating financial information for guarantors.

Personnel changes

SEC Commissioner Lee plans not to seek a second term

Allison Herren Lee said she intends not to seek a second term as commissioner and will step down once her successor has been confirmed. Ms. Lee has been a commissioner since 2019 and served as acting chair of the agency from January 2021 to April 2021.

Enforcement activities

Crypto service provider charged with failing to register product offers and sales

The SEC charged a crypto service provider with failing to register the offers and sales of its retail crypto lending product and with violating the registration provisions of the Investment Company Act of 1940. To settle these charges (without admitting or denying the SEC's findings), the company agreed to pay a $50 million penalty, cease offers and sales of the unregistered lending product, and attempt to bring its business within the provisions of the Investment Company Act within 60 days. In parallel actions, the company also agreed to pay an additional $50 million in fines to 32 states to settle similar charges.

According to the SEC's order, the crypto lending product is a security under applicable law, and the company was therefore required to register its offers and sales but failed to do so or to qualify for an exemption from SEC registration. Additionally, the order asserted that the company operated for more than 18 months as an unregistered investment company because it issued securities and also held more than 40% of its total assets, excluding cash, in investment securities, including loans of crypto assets to institutional borrowers. The order also asserted that the company made a false and misleading statement for more than two years on its website concerning the level of risk in its loan portfolio and lending activity.

> "... [C]rypto markets must comply with time-tested securities laws, such as the Securities Act of 1933 and the Investment Company Act of 1940."
>
> — SEC Chairman Gary Gensler

Founder of investment advisory firm charged with valuation fraud

The SEC filed a complaint charging the founder and former executive of an investment advisory firm with violating antifraud and other provisions of federal securities law by overvaluing assets by more than $1 billion to generate increased fees. The individual also faces criminal charges filed by federal prosecutors and civil charges filed by the Commodity Futures Trading Commission.

The SEC's complaint alleges that assets held in certain funds were overvalued as the result of a fraudulent scheme executed by altering inputs and manipulating the code of a third-party pricing service used to value the funds' assets. The SEC also alleged the former executive backdated minutes of valuation meetings that never occurred and sent forged term sheets to the funds' auditors.

The SEC's complaint seeks permanent injunctive relief, return of allegedly ill-gotten gains, and civil penalties. The SEC also seeks to bar the former executive from serving as a public company officer and director.

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What's next at the SEC?

The SEC's 2022 agenda under the leadership of Chair Gensler is proving to be active and wide ranging. Additional rulemaking expected in the first half of 2022 includes proposals related to disclosures on human capital and corporate board diversity. The SEC is expected to consider input related to its proposed amendments to insider trading plan rules, clawbacks and pay versus performance. In addition, the SEC is expected to prioritize required rulemaking under the Dodd-Frank Act and review and potentially modify aspects of the proxy process.

While the SEC's regulatory agenda currently doesn't specify any digital asset-related rulemaking, the SEC is expected to continue considering whether and how to bring the digital asset industry further under the financial regulatory umbrella, including collaborating with other financial regulators.

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SCORE No. 15603-221US

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