Governance & Securities
Alert

Weil

From the Public Company Advisory Group of Weil, Gotshal & Manges LLP

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Heads Up for the 2022 Proxy Season:

Key Disclosure and Engagement Topics

Public companies and their boards of directors continue to be challenged to address the demands of a broad range of stakeholders, including shareholders, employees, customers, suppliers, unions, regulators and the community. Environmental, social and governance (ESG) matters have become a key business priority alongside traditional financial and strategic imperatives. Moreover, stakeholders are evaluating how public companies are addressing the challenges and opportunities presented by myriad issues, including the continued prevalence of the COVID-19 pandemic, supply chain, human capital, environment and other ESG issues, as well as the overall economic and regulatory environment. The growing importance of aligning strategy and long-term success with ESG has placed added pressure on public companies to provide ESG-related disclosure beyond what is required by SEC rules. In this Alert, we highlight some of the most pressing topics for public companies to consider for their reporting and engagement with key stakeholders during the 2022 proxy season.

We discuss Key Financial Reporting Tips for Form 10-K Drafters in our Alert available here. Companies should also familiarize themselves with the latest ISS and Glass Lewis policies for the 2022 proxy season, which we discussed in our Alert available here.

Key Topics for Consideration for 2022 Proxy Statement

- Corporate Purpose
- Virtual Meetings
- Shareholder Proposals
- ESG Disclosure
- Board Diversity
- Executive Compensation and Human Capital Disclosure
- Climate!
- Universal Proxy

Renewed Focus on a Clear Purpose to Advance Long-Term Profitability

As companies work to manage the current operating environment and lead their companies to long-term profitability it "**has never been more essential for CEOs to have a consistent voice, a clear purpose, a coherent strategy, and a long-term view**," says BlackRock's CEO Larry Fink in his 2022 letter to CEO's, available here. As discussed in this Alert, critical engagement and disclosure topics on human capital issues such was worker turnover, demand for talent, employee engagement and diversity, as well as on climate change, should be integrally linked to the company's purpose.

What to Do Now:

- **Align and engage on corporate purposes and strategy.** Consider how the company's strategy is informed by the risks and opportunities presented to the company in light of various macro factors, including technology, the COVID-19 pandemic, the global economy, environmental, social and governance (ESG) factors and market opportunities. Companies should continue to engage with their stakeholders amid changing social behaviors, customer demands and specific risks facing the company. Companies should use proxy and annual meeting season as an opportunity to reconnect with shareholders and other key stakeholders, whether through engagement or through their public disclosure.
- **Refresh dialogue and strategy on company's purpose.** Management and the board of directors should maintain an active dialogue on the company's purpose and engage with the workforce at all levels to understand and harness their collective purposes and drive connections with the organization more broadly.

Virtual Meetings

The number of companies holding virtual annual shareholder meetings has grown exponentially since the COVID-19 pandemic took hold in early 2020. According to Broadridge, during the first half of 2021 alone, it hosted nearly 2,000 virtual shareholder meetings, with 98% of those being virtual-only. Over 90% of the S&P 500 offered shareholders the option to attend their annual meeting virtually in 2021. We expect many companies to continue to take advantage of virtual-only or hybrid annual meetings during the 2022 proxy season due to the continued uncertainty around the pandemic. During the 2020 proxy season in response to the COVID-19 pandemic, both ISS and Glass Lewis issued emergency guidance on virtual meetings, available here and here, and have also updated aspects of their policies on virtual meetings. Starting in 2021, it is ISS's policy to support management proposals seeking shareholder approval to hold shareholder meetings by electronic means, so long as the proposals do not preclude in-person meetings. ISS has noted that evolving technological capabilities could provide a virtual meeting experience that sufficiently approximates an in-person meeting but encourages companies to disclose the circumstances under which virtual-only meetings would be held and allow for comparable rights and opportunities for shareholders to participate electronically as they would have during an in-person meeting. Similarly, Glass Lewis, which has traditionally not supported virtual-only meetings, released updated guidance, available here, that it will support companies facilitating the virtual participation of shareholders and expects "robust" proxy statement disclosure addressing the ability of shareholders to participate in the meeting, including shareholders' ability to ask questions at the meeting, procedures, if any, for posting appropriate questions received by the company during the meeting and the company's responses on the company's website, and logistical details for meeting access and technical support. Glass Lewis will generally recommend voting against members of the governance committee where the board is planning to hold a virtual-only shareholder meeting and the company does not provide such disclosure.

What to Do Now:

- **Confirm that state law permits virtual or hybrid meetings.** Companies considering virtual-only or hybrid meetings should ensure that their selected format is permissible under state law. A majority of states, including Delaware, permit virtual-only annual meetings, with a handful of states permitting hybrid annual meetings so long as there is a still an in-person component. Some states such as California permit virtual meetings but add difficult conditions such as obtaining prior consent from shareholders, and a few states still preclude virtual-only or hybrid meetings all together. Some states, including New York and New Jersey, have recently passed legislation to make permanent prior temporary executive orders allowing for virtual annual meetings.
- **Review organizational documents and obtain board approval.** Review company bylaws and the certificate of incorporation to ensure that there are no restrictions or other significant conditions on the company's ability to hold the annual meeting remotely. Some states require that the board of directors authorize virtual or hybrid meetings.
- **Engage service providers.** If a virtual meeting is being considered, it is helpful to begin making arrangements with third-party service providers well in advance of the proxy statement filing and annual meeting in order to obtain the desired dates, times and services and avoid technical difficulties.
- **Consider investor feedback and learn from prior years.** Consider feedback from investors on the prior years' annual meetings, including with respect to the format, the interface with the company for virtual formats and investors' ability to engage with the company. Consider prior years' experience and ways to improve the experience for the company and shareholders and improve on any technical difficulties experienced, including the insights from the Report of the 2020 Multi-Stakeholder Working Group on Practices for Virtual Shareholder Meetings. Additionally, consider the 2020 guidance from ISS and Glass Lewis and their subsequent policy updates when establishing your virtual meeting format and related disclosure and communications to shareholders about the meeting.
- **Review the latest SEC guidance on conducting shareholder meetings in light of COVID-19.** On January 21, 2022, the SEC Division of Corporation Finance released an update to its previous shareholder meeting guidance relating to COVID-19 from 2020. Similar to its prior guidance with respect to shareholder meeting format, if a company plans to conduct a "virtual" or "hybrid" meeting, the SEC Staff continues to expect the company to notify its shareholders, intermediaries in the proxy process and other market participants of its plans in a timely manner and clearly disclose logistical details of the meeting, including how shareholders can remotely access, participate in, and vote.
- **Coordinate with shareholder proponents.** The SEC Staff expressly extended to annual meetings held in 2022 its prior guidance encouraging companies to provide shareholder proponents or their representatives with alternative means (such as by telephone) to attend the meeting to present their proposals as they are required to do by SEC Rule 14a-8(h). The SEC Staff has also stated that if the proponent cannot attend because of a COVID-19-related hardship, the absence would be "good cause" and could not be a basis for the company to exclude a future proposal under Rule 14a-8(h)(3). Companies should coordinate with shareholder proponents in advance about the logistics of presenting their proposals to ensure that the proponent cannot later suggest that the company did not provide sufficient means for the proponent or representative to present the proposal.

Shareholder Proposals

Amendments to Rule 14a-8 Applicable for 2022 Meetings. As we discussed in our prior Alert here, amendments to Rule 14a-8, which establishes the eligibility standards and process for the submission of shareholder proposals to be included in a company's proxy statement, are effective and currently apply to any shareholder proposal submitted for an annual or special meeting to be held on or after January 1, 2022 (although the SEC's regulatory agenda suggests that these rules may be further amended in the spring of 2022). Highlights of the new rules as in effect are as follows:

- ***Ownership thresholds.*** Under the old Rule, stock ownership thresholds for a proponent's initial submission required holding at least $2,000 or 1% worth of a company's eligible securities for at least one year through the date of the shareholder meeting. This was replaced by the new Rule with a three-tier stock ownership threshold that ties a longer minimum holding period to a smaller amount of stock (in market value): $2,000 for 3 years; $15,000 for 2 years; or $25,000 for 1 year. The new Rule does provide a one-year phase-in if the proponent owned at least $2,000 for at least one year as of January 3, 2021.
- ***Aggregation of ownership.*** Proponents may not aggregate a small stock holding with that of other small shareholders (either directly or indirectly via a shareholder representative) to meet the eligibility threshold. Co-filing of shareholder proposals is still permitted but only if each proponent is eligible.
- ***One proposal per company.*** A proponent may not submit more than one proposal to a company for the same shareholder meeting, either directly or indirectly through the use of a representative.
- ***Engagement.*** A proponent must state that the proponent is able to engage with the company, in person or by teleconference, within a brief specified period after the initial submission.
- ***Resubmission thresholds.*** Resubmission thresholds were raised for "repeat" proposals submitted and voted on multiple times during the past 5 calendar years, from 3% (first vote), 6% (second vote within the preceding 3 calendar years) and 10% (third/more vote within 3 calendar years of the last vote), to 5%, 15% and 25%, respectively. Aggregation of smaller holdings will not be permitted.

New SEC Staff Legal Bulletin 14L – Opens Flood Gates for Human Capital and Climate Proposals. In light of new Staff Legal Bulletin 14L (SLB 14L) issued on November 3, 2021, as discussed in our Alert here, we expect that companies may no longer be able to exclude certain shareholder proposals focusing on human capital and climate change matters in particular. SLB 14L clarifies the Staff's standard of review of shareholder proposals and aims to streamline and simplify the SEC Staff's review process. It also rescinds the last three Staff Legal Bulletins (Staff Legal Bulletin 14I (Nov. 1, 2017), Staff Legal Bulletin 14J (Oct. 23, 2018) and Staff Legal Bulletin 14K (Oct. 16, 2019)). The Staff's new approach to Rule 14a-8 no-action requests based on Rule 14a-8(i)(7) "ordinary business" and (i)(5) "economic relevance" is as follows:

- ***No significant "nexus" required for significant policy exception.*** Proponents are no longer required to demonstrate a significant nexus between the specific company and the policy issue, rather the SEC Staff will consider more generally whether the proposal raises an issue with a broad societal impact that transcends the ordinary business of the company. This is particularly pertinent to policy issues regarding human capital management and climate change, which continue to be policy issues in the SEC's crosshairs. The SEC Staff expressly stated that: "*Under this realigned approach, proposals that the staff previously viewed as excludable because they did not appear to raise a policy issue of significance for the company may no longer be viewed as excludable under Rule 14a-8(i)(7). For example, proposals squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company.*"
- ***Micromanagement more difficult.*** The SEC Staff will take a "measured" approach to evaluating companies' micromanagement arguments – recognizing that proposals seeking detail or seeking to promote timeframes or methods do not per se constitute micromanagement. Instead, the Staff will focus on the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management. The Staff expressly stated that: "*While the analysis in this bulletin may apply to any subject matter, many of the proposals addressed in the rescinded SLBs requested companies adopt timeframes or targets to address climate change that the staff concurred were excludable on micromanagement grounds. Going forward we would not concur in the exclusion of similar proposals that suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals.*"

- ***No economic relevance threshold.*** The SEC Staff eliminated the threshold of economic relevance. Previously, a proposal could be excluded if it "relate[d] to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business."
- ***Focus on limit on discretion of the board or management.*** The SEC Staff will no longer focus its analysis on whether a proposal seeks intricate detail or imposes a specific strategy, method, action, outcome or timeline on management for addressing a significant issue in a way that supplanted the board and management's judgement in managing matters of a complex nature to find that the proposal is per se micromanagement. Instead, the SEC Staff will focus on the level of granularity sought in the proposal, and whether and to what extent it inappropriately limits discretion of the board or management.

Shareholder Proposal Trends: What to Expect. According to ISS Governance Analytics data, the number of shareholder proposals that were either voted on by shareholders, withdrawn by the proponent or omitted by the Company increased to over 900 in 2021 from nearly 850 in 2020, largely driven by an increase in ESG-related proposals, which are garnering increased support from shareholders. For the 2021 proxy season, the most common proposal topics focused on workplace diversity and EEO-1 reporting, civil rights and racial justice, political lobbying, climate change, ability for shareholders to act by written consent, independent chairpersons and the ability for shareholders to call special meetings. ESG proposals that passed in 2021 most notably include proposals on political spending disclosure, climate change and diversity, equity and inclusion proposals, including EEO-1 reporting and workforce DEI progress reporting. We generally expect that the number of shareholder proposals submitted in 2022 will increase driven in part by the expectation that companies will not be able to exclude proposals that they may have been able to exclude in the past in light of SLB 14L. As a result, we also expect that many more companies will be focused on engaging with proponents to consider the concerns raised by the proposals and whether and how to address them. Unless settlements are reached during these engagements, we expect there will be an uptick in proposals put to a shareholder vote in 2022.

What to Do Now:

- **Apply new Rule 14a-8 standards.** When reviewing shareholder proposals submitted for the 2022 annual meeting, confirm that the proponent and the proposals satisfy the revised rule requirements and explore any procedural deficiencies first. See above and our prior Alert here.
- **Strategically evaluate alternatives.** In light of the influx of proposals so far for 2022 annual meetings, companies should evaluate available alternatives and deploy their resources strategically. Each proposal received may require a different approach, which may include one or more of the following:
  - **Engage with proponent.** Engaging with the proponent is often the most prudent course of action even if no-action relief is ultimately requested. Engagement demonstrates the company's willingness to consider shareholder perspectives. Factors to consider prior to engaging include the size of the investor's ownership, the significance and relevance of the proposal and how the proposal has fared in prior years, if applicable.
  - **Analyze proposals through the SEC's new lens.** Upon receipt of a shareholder proposal that touches on a potentially significant policy issue, consider the granularity of the proposal and whether the proposal "*inappropriately limits discretion of the board or management*," which are the areas of focus for the SEC Staff under SLB 14L.
  - **Submit request for no-action.** If there is a supportable argument for exclusion of the proposal, a no-action request to the SEC Staff may be an appropriate path. The company should consider results of prior year's engagement efforts, support for prior proposals, previously submitted no-action letters and the SEC Staff's most recent guidance, including SLB 14L, as well as the company's timeline. In light of the increased volume of shareholder proposals and, as a result, no action letters submitted to the SEC, the review and response process may take some time, especially because the SEC Staff has reverted to its prior practice of responding to each letter.

- **Include shareholder proposal in proxy statement.** Given the potential difficulty of excluding many shareholder proposals under new SLB 14L, we expect that companies will opt to include more shareholder proposals in their proxy statements. Including the proposals may provide the company with an opportunity to understand its shareholders' views on specific topics that could help to inform the company's approach to such topics going forward.

- **Understand ISS and Glass Lewis implications for director elections and proposals.** As discussed in our prior Alert here, ISS and Glass Lewis policy updates for the 2022 proxy season focused on the accountability of the board of directors and its committees for oversight of environmental, social and governance issues, including board diversity, climate responsibility and shareholder rights. Companies should familiarize themselves and their boards with the new and updated policies, which will influence the results of director elections and support for shareholder proposals in the 2022 proxy season.

Environmental, Social and Governance (ESG) Disclosure

"ESG Story" in Proxy Statement. The focus on environmental and social issues continues to dominate the engagement priorities of institutional investors. Investors and the SEC are reviewing company disclosures to understand their commitment and approach to overseeing risks relating to climate change, sustainability and social responsibility matters. In particular, they are looking for measurable results that demonstrate commitments and related oversight. Accordingly, more companies are enhancing disclosure in their proxy statements by highlighting board oversight of ESG, including specific allocations across committees, disclosure in alignment with the Task Force on Climate-related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) frameworks, identifying priorities and measurable goals and highlighting progress toward such goals and how the company has been recognized by third parties.

What to Do Now:

- **Enhance disclosure around board and committee accountability and oversight of ESG.** Companies should review and update disclosure relating to oversight of ESG initiatives and how ESG is linked to company-wide strategic planning decisions wherever relevant. Beginning in 2022, Glass Lewis will generally recommend voting against the chair of the governance committee of companies in the S&P 500 index who fail to provide explicit disclosure concerning the board's role in overseeing environmental and/or social issues. For companies in the Russell 1000 and instances where Glass Lewis identifies material oversight concerns, Glass Lewis will review a company's proxy statement and governing documents (such as committee charters) to determine if directors maintain a meaningful level of oversight of and accountability for a company's material environmental and social impacts.
- **Understand and be prepared to engage with major investors.** Companies should expect and be prepared to engage with shareholders on various ESG matters. In their recently published proxy season voting and engagement guidelines, major institutional investors such as BlackRock, State Street, Vanguard and others have identified ESG issues as some of their most significant engagement priorities.
- **Ensure disclosure is consistent.** Companies preparing ESG or sustainability reports should ensure that disclosure in such reports is consistent with Form 10-K and proxy statement disclosure and across the company's communications platforms and SEC filings. In September 2021, the Division of Corporation Finance published a Sample Comment Letter, highlighting comments addressing climate change disclosure in particular. Notably, the first sample comment requested an explanation of what consideration the company gave to providing the same type of climate-related disclosure in the company's SEC filings as the company included in its corporate social responsibility (CSR) report.
- **Disclose director ESG-related skills.** Highlight skills and expertise of board members that bear on their ability to oversee ESG risks facing the company and its industry.

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Board Diversity

Board Diversity. Although there has been progress in improving diversity in the boardroom in the last two years, according to ISS Corporate Solutions, directors from underrepresented groups still account for only 17% of public company directors while female directors comprise approximately 27%. Regulators, investors and proxy advisory firms continue to focus on increasing board gender and racial diversity. As companies focus on their proxy statements for their 2022 annual meetings, it is important to understand the lens through which their various constituencies will scrutinize board and workforce diversity disclosure and prepare disclosure that provides a meaningful picture of the company's board diversity and DEI initiatives. See our prior Alert here for a deeper dive on board diversity issues.

Nasdaq Board Diversity Rule. In August 2021, the SEC approved Nasdaq's new board diversity listing standards, underscoring the increased market focus on enhancing board diversity. Pursuant to new Nasdaq Rule 5605(f) (Diverse Board Representation) and 5606 (Board Diversity Disclosure), Nasdaq-listed companies (with certain exceptions) must (1) provide annual public disclosure of board diversity statistics using a standardized template and (2) have, or explain why the company does not have, at least two "diverse" board members, including at least one director who self-identifies as female and at least one director who self-identifies as an "Underrepresented Minority" or "LGBTQ+." The board diversity matrix is required by the later of August 8, 2022 or the date on which the company files its 2022 proxy statement. The rules pertaining to board composition will phase in starting in 2023 depending on a company's size and listing tier. See "Diversity Policies At-A-Glance" below.

Diversity Policies At-A-Glance

ISS

- At least one gender diverse director at Russell 3000 or S&P 1500 companies for annual meetings held on or after February 1, 2022
- At least one racially/ethnically diverse director at Russell 3000 or S&P 1500 companies for annual meetings held on or after February 1, 2022
- At least one gender diverse director at all companies for annual meetings held on or after February 1, 2023

Glass Lewis

- At least two gender diverse directors at all Russell 3000 companies for annual meetings held on or after January 1, 2022
- At least one gender diverse director at all companies with six or fewer directors for annual meetings held on or after January 1, 2022
- At least 30% gender diverse directors at all Russell 3000 companies for annual meetings held on or after January 1, 2023
- Following state law mandates on board diversity for annual meetings held on or after January 1, 2022
- Nasdaq listed companies must provide required disclosure by August 8, 2022 (see below)

For Nasdaq-Listed Companies

- Disclose in proxy statement or on website the Nasdaq-required board matrix for the later of the date a company files its proxy statement for the 2022 annual meeting or August 8, 2022
- Have one diverse director or explain why none (including boards with five or fewer directors) starting with the later of the date a company files its proxy statement for the 2023 annual meeting or August 7, 2023
- For boards with six or more directors, have two diverse directors or explain why not starting with the later of the date a company files its proxy statement for the 2025 annual meeting or August 6, 2025, for companies listed on the Nasdaq Global Select Market or Nasdaq Global Market, and the date a company files its proxy statement for the 2026 annual meeting or August 6, 2026, for companies listed on the Nasdaq Capital Market
- Generally, a one-year phase-in for newly public companies and a grace period for vacancies are permitted

What to Do Now:

- **Nasdaq companies – prepare disclosure and consider board succession planning.** Nasdaq-listed companies should be proactive in preparing their boards of directors for the new diversity disclosure matrix requirements. Such companies should also assess board composition and consider director succession planning in light of the new diversity requirements.
- **Remember SEC-required disclosure.** Companies should disclose in their proxy statements any changes made to the director nomination process or board diversity policy, as companies are required to disclose if and how diversity is considered as a factor in the process for considering candidates for board positions. Moreover, under guidance from the SEC Staff, it is expected that companies disclose, with a director consent, the self-identified characteristics the board or nominating committee has considered in determining the specific experience, qualifications, attributes or skills of an individual for board membership (see Regulation S-K C&DI Question 116.11 and Question 133.13). While historically the SEC has opted for a principles-based materiality regime for diversity disclosure giving broad discretion to companies, the anticipated rule proposals on the SEC's rule making agenda may take a different approach.
- **Update D&O Questionnaires.** Consider how to best obtain information from directors regarding their diversity and backgrounds, including by making updates to D&O questionnaires.
- **Consider "Rooney Rule" policies.** In response to continued letter writing campaigns and shareholder proposals, we anticipate that companies in larger numbers will adopt a "Rooney Rule" policy, requiring diverse individuals based on gender, race and ethnicity to be included in formal searches for new directors and, in some cases, in searches for CEOs and other open executive positions.
- **Conduct annual board evaluations.** The board should continue to evaluate its own composition, including its leadership, competencies, independence, diversity, tenure and effectiveness, to determine whether it aligns with the company's strategic objectives.
- **Stay informed on state law requirements.** A number of states have adopted and are considering board diversity legislation, including gender and race. Companies should stay up to date on state initiatives and requirements with respect to board composition. Glass Lewis will look to applicable state laws when making its voting recommendations in director elections.

Executive Compensation and Human Capital Disclosure

ESG-Linked Compensation Metrics. Public companies and their compensation committees are under increasing demands to reflect ESG-related goals and measures in their executive compensation program, and many companies are beginning to incorporate, or considering how and whether to incorporate, such measures into executive compensation decisions. Based on a 2021 study by Pearl Meyer, available here, 19% of public company respondents (21% for those with revenues of $10 billion or more) reported that they intend to add one or more formal ESG metric in 2022. These measures are more often included in the short-term compensation program and may include goals such as customer satisfaction and safety, as well as diversity metrics. Although many companies agree that ESG metrics should be factored into the executive compensation decisions, companies still struggle with challenges in identifying the appropriate metrics and how to set targets, especially for the long-term.

Perquisites Sweep. The SEC Division of Enforcement remains focused on executive perks and benefits and has continued with a sweep of perquisite disclosures and subsequent enforcement actions in 2021 as it did in 2020 and 2019. The SEC has brought several enforcement proceedings against companies that failed to disclose personal expenses and travel expenses, including use of corporate aircraft for personal reasons. These cases often involve findings of deficiencies in internal controls. For example, in August, the SEC settled charges with one company which allegedly failed to evaluate and disclose 33 flights by its CEO that were financed by the company but not "integrally and directly related" to the CEO's professional duties. Most recently in November, the SEC settled charges against another company and its former CEO, where it highlighted the company's lack of a formal policy regarding approval and use of noncommercial aircraft and process of reimbursement of private aviation expenses.

COVID-Perquisite Guidance. In September 2020, the SEC Staff issued new Regulation S-K C&DI Question 219.05, which confirms that the SEC's two-step analysis applies in evaluating whether benefits provided to executive officers because of the COVID-19 pandemic constitute perquisites or personal benefits. The SEC noted that whether an item is "integrally and directly related" to the performance of the executive's duties depends on the particular facts. The C&DI provided several examples: enhanced technology needed to make the executive's home his or her primary workplace upon imposition of local stay-at-home orders would generally not be a perquisite or personal benefit because of the integral and direct relationship to the performance of the executive's duties. On the other hand, items such as new health-related or personal transportation benefits provided to address new risks arising because of COVID-19, if they are not integrally and directly related to the performance of the executive's duties, may be perquisites or personal benefits even if the company would not have provided the benefit but for the COVID-19 pandemic, unless they are generally available to all employees.

Clawbacks. On October 14, 2021, the SEC reopened the comment period to solicit input on the controversial clawback rules it proposed in 2015 to implement the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and also sought comment on additional questions that could inform further changes by the SEC to the proposed rule. If adopted, the SEC's proposed rule would direct the national securities exchanges to establish listing standards requiring companies to adopt, disclose and comply with a compensation clawback policy as a condition to listing. The clawback policy contemplated by the proposed rule is fairly prescriptive, leaves little discretion and would mandate recovery of incentive-based compensation from current and former executive officers who received such compensation during the three fiscal years preceding the date on which the listed company is required to prepare an accounting restatement to correct a material error. The additional questions posed by the SEC asked about, among other things, whether the types of accounting restatements to which the rules would apply should be expected to include restatements made to correct *all* errors to previously issued financial statements instead of only restatements to correct *material* errors and whether companies should be required to disclose how they calculated the amount to be recovered by the executive. When the SEC adopts the rule, it will then receive amended listing standard proposals from the stock exchanges for approval.

COVID-19 Related Compensation Adjustments. Following the second year of the COVID-19 pandemic, we expect to see fewer compensation related adjustments related to 2021 executive compensation decisions. However, companies that continue to be significantly detrimentally impacted and have made compensation adjustments due to the ongoing pandemic should ensure that they address in the compensation discussion and analysis (CD&A) in the proxy statement decisions made and the rationale for any adjustments. In December 2021, ISS released 11 FAQs on how it would review pandemic-related adjustments to short and long-term executive compensation decisions.

EEO-1 Disclosure. Disclosure of Consolidated EEO-1 Reports is becoming the "gold standard" for investors. These annual reports provided to the U.S. Equal Employment Opportunity Commission include the race, gender and ethnicity of the employees in various job categories, including senior management. The Office of the Comptroller of New York City has been actively submitting proposals and engaging with companies to disclose this data and announced here that as a result of its successful campaign, at least 84 then current S&P 100 companies (as of December 30, 2021) disclose or have committed to disclose their EEO-1 reports. As discussed above, in 2021, 42 shareholder proposals requested such disclosure, many of which settled based on the company's agreement to make the report or excerpts available. Of the three proposals that went to a vote, two passed with an average of 70% support. In January 2022, State Street Global Advisors announced in its annual letter to boards of portfolio companies that it will take action against responsible directors, including the compensation committee chair, at companies in the S&P 500 that do not disclose their EEO-1 report.

Spring-Loaded Compensation Awards. As discussed in our 10-K Reporting Alert, the SEC issued accounting guidance on "spring-loaded" compensation awards in the form of new Staff Accounting Bulletin No. 120 (SAB 120). For example, a concern is that a company could be understating compensation expense when stock options are granted at a time when the company has material nonpublic information that is positive (MNPI) concerns the company's stock price SAB 120 requires certain disclosures in MD&A (and financial statement footnotes) regarding the estimation of the fair value of equity grants made when the company or its insiders are aware of MNPI. Among other things, at a minimum, a company that has granted options or other securities tied to the company's common stock while aware of MNPI must determine whether its evaluation of factors, such as consideration of future events in estimating expected volatility, resulted in an estimate that involves a significant level of estimation uncertainty and has had or is reasonably likely to have a material impact on the financial condition or results of operations of the company. SAB 120 relates to all equity awards, not just options.

Human Capital Disclosure. Amendments to Regulation S-K that became effective November 9, 2020 require companies to disclose in the Form 10-K information about material human capital resources, measures or objectives that management focuses on in managing its business. Because the SEC has not defined the term "human capital management," companies are taking a variety of approaches to comply with the disclosure rule. Generally, companies have included disclosure relating to workforce composition and demographics, talent and succession planning, employee compensation, COVID-19 pandemic response, diversity, equity and inclusion in the workplace, and employee training and retention. A small number of companies are beginning to disclose future goals and measures. Companies should continue to expect additional rule making by the SEC on human capital disclosure. The SEC's rule making agenda includes additional proposed rules on human capital disclosure, including relating to workforce diversity and corporate board diversity. Moreover, human capital management remains a strategic priority for management and the board, as well as a key engagement priority for investors. In addition to critical health and safety concerns relating to the pandemic, the range of human-capital issues for management to tackle includes employee retention, compensation, training and development, diversity and inclusion, and adapting the workforce to remote environments.

What to Do Now:

- **Evaluate whether and how ESG targets can be linked to executive compensation.** Institutional investors expect companies to hold executives accountable for ESG goals and are identifying as a priority whether company disclosure on whether executive compensation is linked, at least in part, to ESG goals. Companies should consider performing periodic ESG materiality assessments in order to identify, manage and integrate ESG elements that are meaningful to their businesses into their strategy and measure them against relevant compensation metrics. Companies should also review peer company metrics and work with their compensation consultants to implement the appropriate awards and relevant metrics consistent with their compensation philosophy.

- **Train legal team, executives and directors on perks – implement controls.** Companies should train directors and officers (and sometimes their assistants) and legal and accounting staff involved with implementing internal controls and procedures relating to perquisites on the SEC's definition of when an item constitutes a perquisite or a personal benefit – whether the item is "integrally and directly related" to the performance of the executive's or director's duties – as well as tracking the incremental costs of perquisites to the company. Companies should review internal controls and procedures relating to detecting, valuing and disclosing executive and director perquisites. Efforts including engaging third-party compensation consultants and implementing compliance policies concerning travel, expense reimbursement, charitable contributions and aircraft usage, among other things, have previously resulted in reduced enforcement fines.
- **Review clawback provisions and policies.** As proposed by the SEC, there is very limited discretion with respect to when a company could choose not to seek recovery pursuant to a clawback policy. Companies will need to undertake a complete review of existing clawback provisions under executive employment agreements, equity plans and award agreements and any other relevant contracts in anticipation of the adoption of new rules to help ensure a smooth transition, where relevant.
- **Ensure sufficient back up and support for human capital disclosure.** In light of the second year of human capital resources disclosure, companies should ensure that they have sufficient support for the metrics, goals and achievements disclosed.
- **Review say-on-pay results.** Overall, say-on-pay proposals continue to garner majority support. Companies should review the prior year's say-on-pay result and feedback from investor engagement efforts to support this year's say-on-pay disclosure and executive compensation decision making. In addition, the CD&A requires companies to disclose whether and, if so, how the company has considered the results of the most recent say-on-pay vote and, if so, how that consideration has affected the company's executive compensation decisions and policies.

Climate!

Institutional Investors Focus on Climate Risk. Investors continue to focus on climate change risks in companies' long-term prospects. Blackrock explicitly considers a company's plan or actions on climate change when voting on directors, particularly at companies facing material climate risks. State Street, in its recent letter to directors, stated that they will launch a targeted engagement campaign with the most significant GHG emitters in their portfolio to encourage the adoption and implementation of climate transition plans and, starting in 2023, they will hold directors accountable for failing to do so. Vanguard has also indicated that its funds are likely to support proposals that request, among other things, disclosure on how climate change risks are incorporated into strategy and capital allocation decisions or ask for an assessment of climate impact. As discussed above, Larry Fink, in his annual letter to CEOs stated that **"[e]very company and every industry will be transformed by the transition to a net zero world. The question is, will you lead, or will you be led?"** In October 2021, trustees of three New York City pension funds committed to redirect the city's $50 billion retirement fund away from fossil fuels and toward investments in clean and renewable energy, with the mission to generate net-zero carbon emissions by 2040.

Climate Activism. The 2021 proxy season saw the successful proxy contest at ExxonMobil where a new hedge fund called Engine No. 1 was able to leverage environmental and governance issues to win three board seats. Engine No. 1's campaign focused on its claim that Exxon's board has failed to develop a clean energy strategy. Moreover, as discussed above, the 2021 proxy season saw significant increase in support for shareholder proposals on environmental and climate matters. In 2021, companies across the board, but especially in the energy (specifically, non-renewable resources) and banking and finance sectors, experienced increased investor scrutiny of their climate risk mitigation and energy transition plans (see the ISS report on climate-related voting trends here).

ISS and Glass Lewis Policies – Say-on-Climate. Climate change continues to be a hot button issue for proxy advisory firms. ISS has recently updated its guidance, disclosure metrics and recommendations on management and shareholder say-on-climate proposals and has also indicated that for companies that are significant GHG emitters, it will generally recommend a vote against or withhold from the chair of the responsible committee overseeing GHG emissions if the company has not taken what ISS considers to be the minimum steps toward understanding, assessing or mitigating emission-related risks to the company and the larger economy. These steps include detailed disclosure of climate-related risks (such as board governance measures, corporate strategy and risk management analysis) and appropriate GHG emissions reduction metrics and targets. In 2022, this policy will only apply to the companies appearing on the Climate Action 100+ Focus Group list, available here. Glass Lewis has maintained its focus on board accountability and states in its policies that it "carefully monitors companies' performance with respect to environmental and social issues," including related to climate. To the extent that Glass Lewis believes that the company has not properly managed or mitigated material environmental risks to the detriment of shareholder value, or such mismanagement has threatened shareholder value, Glass Lewis may recommend against the election of one or more board members responsible for the oversight of such risks. Additionally, ISS and Glass Lewis have updated their policies on say-on-climate management and shareholder proposals, a summary of which is available in our Alert here.

SEC Focus on Climate. SEC Staff has released illustrative comment, available here, that may be issued to companies regarding their climate-related disclosure, or the absence thereof. Depending on companies' particular facts and circumstances, disclosure on climate change may be required as part of the company's description of its business, legal proceedings, risk factors, MD&A and analysis of financial condition and results of operations sections of Form 10-K. Further disclosure may also be required to align filings with more expansive disclosures in companies' CSR or sustainability reports. The SEC is now considering public input on developing updated disclosure rules to supplement its 2010 interpretative release, which first provided guidance on how to consider disclosure of climate change-related risks and opportunities, available here. In a recent interview, SEC Chair Gensler indicated that of the letters received to date on Commissioner Lee's public comment request, three out of every four support some form of mandatory climate disclosure rules. Examples of new disclosure rules under consideration relate to management of climate-related risks and opportunities (whether on a one-size-fits all or based on tiered industry basis), metrics relating to greenhouse gas (GHG) emissions (i.e., disclosure of levels of current and target Scope 1, Scope 2 and Scope 3 emissions), financial impacts of climate change and progress toward climate-related goals. Chair Gensler has indicated that the agency hopes to propose new rules for public comment in early 2022.

What to Do Now:

- **Understand stakeholder views.** Whether the Engine No. 1-style of ESG activism will be successful in the future is yet to be seen. However, as directors will be held accountable at the ballot, it is important for both the company and the board to understand key stakeholder views relating to climate change and actions the company should be taking to support shareholder value with respect to climate change. Companies should brief boards of directors regularly on investor concerns and engagement priorities.
- **Evaluate and disclose material impacts and risks relating to climate change**. Discussion of material risks and impacts relating to climate change has been required since the initial SEC guidance on the topic in 2011. In light of the renewed focus and likelihood of future rulemaking, companies are considering their disclosures in SEC filings and in their various other public disclosures to ensure consistency and the accuracy of the data and information provided in preparation for future rulemaking. See our Key Financial Reporting Tips for Form 10-K Drafters, available here.

Universal Proxy

New Universal Proxy Rules. On November 17, 2021, the SEC adopted proxy rule amendments that require, in a contested election of directors, the company and the shareholder activist to each use a "universal" proxy card – i.e., a card that includes the names of both parties' nominees. These rule amendments will provide activist shareholders with access to a company's proxy card without the minimum ownership requirements or guardrails on the types of proposals that they can put forth by other means of access – e.g., proxy access and the Rule 14a-8 shareholder proposal system, respectively. As discussed in more detail in our Alert here, the new rules, which apply to all contested shareholder meetings involving director elections held after August 31, 2022, except those involving registered investment companies and business development companies, address the following:

- ***Universal proxy card.*** Both public companies and activists must use a universal proxy card when soliciting shareholders in a proxy contest.
- ***Notice of intent to solicit.*** Activists must notify the companies of their intent to solicit proxies and provide nominee names at least 60 calendar days prior to the anniversary of the prior year's annual meeting.
- ***Activist proxy statement deadline.*** Activists must file their proxy statements by the later of 25 calendar days before the shareholder meeting or five calendar days after the company files its definitive proxy statement.
- ***Solicitation period.*** Activists must solicit shareholders, i.e., mail a proxy statement to (including by means of notice and access), representing at least 67% of the company's voting power entitled to vote at the meeting.

The new rules also amend the form of proxy and disclosure requirements relating to voting options and standards that would apply to all director elections, contested or not.

What to Do Now:

- **Review prior director election results and consider engagement strategy.** In approaching the proxy season, consider prior years' director elections results and any vulnerabilities to determine risk of a contested election and evaluate the company's engagement strategy or other strategies for deterring activists.
- **Consent to nomination and D&O questionnaire.** All company director nominees consent to their inclusion in the company's proxy statement as a nominee. Consider including such consent in the director questionnaire, if it is not already part of each director's annual certification in the questionnaire process.
- **Review advance notice bylaw.** Given that activists will be able to use the company's advanced notice provision to nominate directors for inclusion in the company's proxy statement, companies should review their bylaws to confirm that they understand the mechanics of the advanced notice bylaw.
- **Review proxy card and proxy statement.** Confirm voting standard and format of presentation of voting options on proxy card. Consider including in the proxy statement the intent to solicit deadline for the following year.

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