WEBINAR

Getting Ready for the 2022 Proxy and Reporting Season: Getting it Right in 2022

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Speakers: Stephanie Avakian, Krystal Berrini, Donald Cassidy, Molly Fox and Alan Wilson

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WEBINAR

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Disclosure

Upcoming Form 10-Ks

What's New

- S-K 300 Series amendments
- Expanded scope of "IRANNOTICE" disclosure
- New Item 9C (Disclosure Regarding Foreign Jurisdictions that Prevent Inspections)

Other Focus Areas

- Climate change
- Human capital
- Covid-19
- "Hypothetical" risk factors (e.g., cyberincidents)

Amendments to Series 300 of Regulation S-K

- ***The amended rules are effective for a company's first fiscal year ending on or after August 9, 2021***
- ***The amended rules eliminated the following disclosure requirements:***
  - Five years of selected financial data (old S-K 301)
    - Companies should still consider whether trend information for periods earlier than those presented may be useful to an investor
    - Companies should still consider whether a tabular presentation of relevant financial or other information, as part of an introductory section or overview, including to demonstrate material trends, may be useful to an investor
  - Discussion of the impact of inflation and price changes on a company's results unless they are part of a known trend or uncertainty that has had, or the company reasonably believes will have, a material favorable or unfavorable impact on such items (old S-K 303(a)(3))
  - Tabular presentation of a company's known contractual obligations (old S-K 303(a)(5))

Supplementary Financial Data (Item 302(a))

- ***Previous Requirements of Item 302(a) of Regulation S-K:***
  - Disclose selected quarterly financial data of specified operating results
  - Disclose variances in those results from amounts previously reported in a Form 10-Q
- ***Amended Requirements of Item 302(a) of Regulation S-K***
  - Disclosure is now principles-based
  - Only required to disclose material retrospective changes, including an explanation of the reasons for such material changes

MD&A Disclosure Requirements (Item 303)

– ***Summary of Key Changes***

- Adds a new “Objective” section to the rule to clarify the type of information to be included in MD&A with a focus on helping investors understand a company’s business through the eyes of management (S-K 303(a))
- Adopts a “reasonably likely” disclosure threshold that applies to the requirements to describe known material trends or uncertainties
- Clarifies that the requirement to explain material changes from period-to-period calls for quantitative and qualitative analysis and includes discussion of offsetting items (S-K 303(b))
- Requires discussion of material cash requirements from known contractual and other obligations, including a discussion of the type of obligation and the relevant time period for the related cash requirements (S-K 303(b)(1))
- Clarifies that a discussion of material changes in net sales or revenue, rather than just material increases, is required (S-K 303(b)(2)(iii))

MD&A Disclosure Requirements (Item 303) (cont'd)

- ***Summary of Key Changes (cont'd)***
  - Adds a requirement to disclose critical accounting estimates (Item 303(b)(3))
    - The discussion should include, to the extent material:
      - Why the estimate is subject to uncertainty
      - How much each estimate has changed during the relevant period
      - Sensitivity of the reported amounts to the methods, assumptions and estimates
    - This disclosure should supplement – not duplicate – the description of significant accounting policies in the notes to the financial statements
  - Replaces off-balance sheet arrangements disclosure requirement with a new instruction prompting companies to consider providing disclosure of such arrangements within the context of MD&A (Instruction 8 to Item 303(b))
  - Allows the comparison of interim period results to either the prior year period (as is currently required) or the prior sequential period (Item 303(c))

Climate Change Comment Letters

- Public companies have been receiving comments from the Division of Corporation Finance regarding climate change disclosures in their most recent Form 10-K
- The Division of Corporation Finance issued a Sample Comment Letter in September 2021 that reiterates the Commission's 2010 Guidance and identifies the types of comments that may be issued to companies regarding their climate-related disclosure or the absence of such disclosure. The sample comments focus on three main areas:
  - *General disclosure*: disparity between more expansive disclosure in CSR report compared to SEC filings
  - *Risk factors*: disclosure of material effects of transition risks and material litigation risks related to climate change
  - *MD&A*: material climate change-related legislation, regulation and international accords and any material effect on the company; material past and/or future capital expenditures for climate-related projects; material indirect consequences of climate-related regulation or business trends; material physical effects of climate change; material increased compliance costs related to climate change; and material purchase or sale of carbon credits or offsets

Human Capital Disclosure

- Principle-based requirement to report on human capital to the extent material to an understanding of the company
  - Only required disclosure is the number of employees and “any human capital measures or objectives that the registrant focuses on in managing the business”
- General areas of disclosures companies focused on in their 2020 Forms 10-K included:
  - Diversity, equity and inclusion information (e.g., headcount, geographical distribution, job function, education level and full-time versus part-time status)
  - Hiring, learning and development, retention, succession planning and turnover
  - Compensation and benefits
  - Employee feedback (i.e., employee engagement, survey results, workplace safety)
  - COVID-19 impact and response
- Overall, initial disclosures tended to be generic, with few quantitative metrics
  - For the upcoming Form 10-K, companies should consider updating their disclosure to provide meaningful qualitative and quantitative disclosure and also consider additional topics such as pay equity and return to the office or hybrid work policies

Proxy Statement for 2022 Annual Meeting

What's New

- Nasdaq: Diversity matrix
- NYSE: Related party transactions
- NYSE: Counting of abstentions (proposed)

Other Focus Areas

- Board oversight of risks
- Meeting format (physical vs. virtual vs. hybrid)

Board Diversity Matrix (Nasdaq-Listed Domestic Filers)

Board Diversity Matrix (As of [DATE])				
Total Number of Directors	#			
	Female	Male	Non-Binary	**Did Not Disclose Gender**
Part I: Gender Identity				
Directors	#	#	#	#
Part II: Demographic Background				
African American or Black	#	#	#	#
Alaskan Native or Native American	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Did Not Disclose Demographic Background	#			

Nasdaq companies need to disclose board-level diversity data annually, either on the matrix to the left, or a substantially similar format

Companies must disclose the initial matrix in 2022:

- If a company files its 2022 proxy BEFORE August 8, 2022 and DOES NOT include the Matrix, then the company has until August 8, 2022 to provide the Matrix.
- If a company files its 2022 proxy ON or AFTER August 8, 2022, then it must either include the Matrix in its proxy or post the Matrix on its website within one business day of filing its proxy.
- If a company does not intend to file a 2022 proxy, then the company has until August 8, 2022 to provide the Matrix on its website

After the first year of disclosure, companies must disclose the current year and prior year diversity statistics

Auditing and Accounting Developments

- **Non-GAAP disclosures** continue to be the most common area of SEC comment, though the overall incidence of comments continues to decline
- **Revenue recognition** continues to be a popular area of SEC comment, including the presentation of disaggregated revenue, with the SEC looking across all company disclosures (including earnings releases), underscoring the importance of consistency
- Auditors are beginning to evaluate the **financial statement impacts of climate-related risks** (e.g., asset impairments that might be triggered by near term net-zero carbon emissions targets)

Auditing and Accounting Developments

- In April, the SEC issued a statement regarding the **accounting for SPAC warrants**, and the SEC continues to issue new and refined comments on SPAC warrant accounting
- In June, **amended auditor independence rules** went effective, including a new transition framework to avoid inadvertent violations arising in M&A events, updates to the business relationships rule with the concept of beneficial owners with significant influence (vs “substantial stockholders”), and shorter look-back periods for domestic IPO filers, among other changes
- In September, the PCAOB adopted a new rule related to its responsibilities under the **Holding Foreign Companies Accountable Act (HFCAA)**, advancing the implementation of the framework necessary to implement the HFCAA delisting requirement, which is expected to mostly impact companies audited by Chinese auditors
- In September, FASB proposed amendments to its **fair value accounting rules** to clarify conflicting guidance on the unit of account when measuring fair value of equity securities

Reminders

- **XBRL:** The inline XBRL and cover page tagging requirements apply to all filers for fiscal periods ending on or after June 15, 2021
- **Pay Ratio:** Companies that have provided pay ratio disclosure for the past three years using the same median employee (or a substitute employee with respect to such original median employee) need to select a new median employee for the pay ratio disclosure to be included in the company's next proxy statement
- **Frequency Vote:** If a company's initial say-on-frequency vote was held in 2016, the company must include a separate proposal in the proxy statement for the 2022 annual meeting to allow stockholders to vote on the frequency of future say-on-pay votes
- **Electronic Signatures:** Before a signatory uses an electronic signature to sign an SEC filing, the signatory must provide a manually-signed attestation that such individual's electronic signature is the legal equivalent of a manual signature

SEC's Rulemaking Agenda

Disclosure	Compensation
• Climate change • Human capital management • Corporate board diversity • Cybersecurity risk governance	• Clawbacks (Dodd-Frank) • Pay vs. Performance (Dodd-Frank)
Proxy-Related	**Trading**
• Universal proxy • Rule 14a-8 • Proxy voting advice • Reporting of proxy votes (Dodd-Frank) • Beneficial ownership reporting	• Rule 10b5-1 • Rule 144 • Stock buybacks

Mitigating Enforcement and Litigation Risk

Selected 2021 Enforcement Actions

- **Form 12b-25**: Eight companies settled actions for failing to disclose that their delay in timely filing was due to an anticipated restatement or correction of prior financials
- **Perquisites**: Two actions relating to undisclosed CEO perks (including airplane usage), one of which also focused on lack of disclosure controls and procedures
- **Earnings Management**: Three actions relating to improper financial reporting: one relating to undisclosed pull-in sales, one relating to undisclosed side letters and the third relating to failure to timely accrue for litigation settlement costs
- **Cybersecurity**: One company agreed to pay $1 million to settle charges that it misled investors by referring to a data privacy incident as a hypothetical risk, when, in fact, a cyber intrusion had already occurred. Another company agreed to pay $500k for disclosure controls and procedures violations related to a cybersecurity vulnerability that exposed sensitive customer information
- **Regulation FD**: Litigation commenced against a company and three of its IR executives for alleged violations during a series of 1-on-1 calls with analysts

Governance

Investors Evolve Their Approach to Director Accountability

Investors and proxy advisors are holding directors accountable for an expanding list of topics, including climate risk and diversity, necessitating a more complex approach to analysis

Growing Number of Topics Driving Director Votes

Traditional Governance Deficiencies

- Attendance
- Shareholder Rights
- Shareholder Responsiveness
- Oversight Failure
- Independence
- Executive Compensation

Evolving Expectations

- Overboarding
- Board Gender Diversity

Recent Developments

- ESG Disclosure
- Board Racial/Ethnic Diversity
- Climate Goals
- Workforce Diversity

New E&S Policies for Director Elections[1]

BlackRock 2021

> Extended climate accountability into director elections on a systematic basis through its 2021 policy to vote against directors at companies that do not disclose in line with SASB and TCFD or provide a credible plan to transition to a low-carbon economy

STATE STREET GLOBAL ADVISORS 2022

> Against nominating & governance committee chairs on boards with **no members from an underrepresented community**[2]

> Against compensation committee chairs if no disclosure of **EEO-1 survey responses**[3]

Legal & General 2022

> Against board chairs at companies that **do not meet minimum climate standards**

ISS 2022

> Against nominating committee chairs if there are **no racially or ethnically diverse directors**[4]

> Against directors due to demonstrably poor risk **oversight of E&S issues**

GLASS LEWIS 2022

> Against nominating committee chairs if there are **fewer than two female directors**[5]

> Against governance committee chairs for failure to provide **disclosure around board oversight of E&S risks**[4]

Takeaway

✓ *Director votes are increasingly at risk because of the compounding impact of these policy changes*

(1) Voting policy information sourced from investor and proxy advisor websites.
(2) Applies to S&P 500 and FTSE 100 companies.
(3) Applies to S&P 500 companies.
(4) Applies to Russell 3000 and S&P 1500 companies.
(5) May not recommend against directors at companies outside the Russell 3000.

Traditional Governance Proposals Maintain Momentum

While individual investors are the primary proponents of governance-focused proposals, they continue to receive broad levels of institutional investor support

Key Statistics for Governance-Focused Proposals 2020 vs 2021[1]	215 vs **231** Submitted	180 vs **180** Voted	20 vs **28** Passed

Governance Shareholder Proposal Submissions and Vote Outcomes[1]

Category	Submitted		Voted		Support		Passed	
	2020	2021	2020	2021	2020	2021	2020	2021
Majority / Supermajority Voting	39	**41**	24	**23**	52%	**69%**	10	**16**
Written Consent	66	**77**	59	**66**	36%	**41%**	3	**8**
Special Meetings	42	**37**	39	**31**	42%	**34%**	5	**4**
Proxy Access	19	**36**	13	**27**	29%	**34%**	0	**0**
Independent Chair	49	**40**	45	**33**	34%	**31%**	2	**0**

Spotlight on Written Consent & Special Meeting Proposals

- Written consent proposals in 2021 took two forms: implement the right and reduce the threshold required to initiate the right to 10%
- The vote on a written consent shareholder proposal is often dependent on the company's special meeting right, as many investors will vote against a written consent shareholder proposal if the company has a special meeting right with a 15% or lower threshold
- Most written consent proposals that pass seek to implement the right. Support is generally higher among companies that do not have a special meeting right or where the threshold to call a meeting is greater than 15%

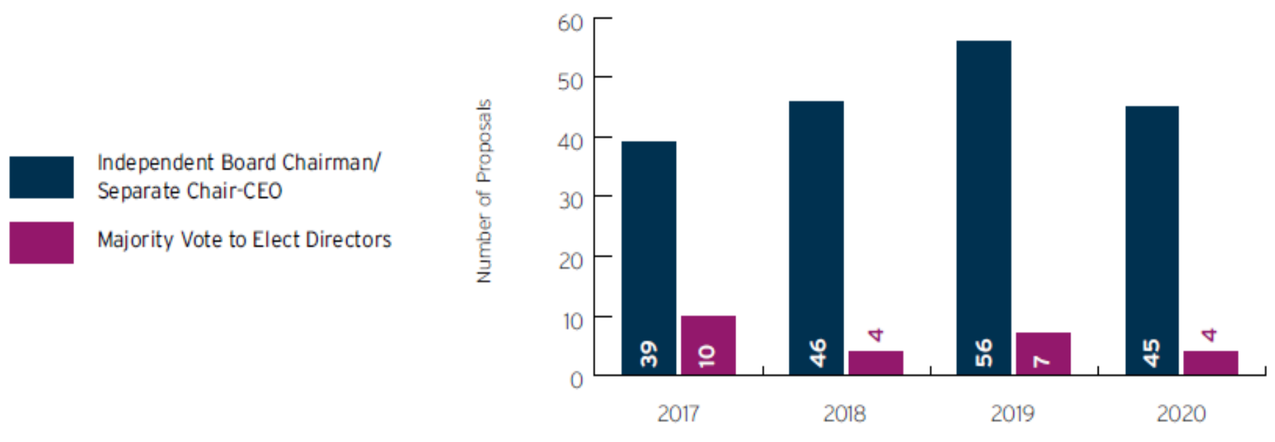
Takeaway

✓ *Governance-focused shareholder proposal submissions are likely to continue but support levels have not experienced the same growth as E&S proposals*

(1) ISS Voting Analytics; data represents proposals submitted at Russell 3000 companies for annual meetings held through June 30th in 2020 and 2021.

Corporate Governance – Increasing Focus on Separation of the Roles of Chair and CEO

Proposals Voted Upon Relating to Board Issues, 2017-2020



Average % of Shareholder Support

	2017	2018	2019	2020
Independent Board Chairman / Separate Chair-CEO	30%	32%	29%	34%
Majority Vote to Elect Directors	54%	62%	57%	22%

Investors such as Wellington and Capital Group are reframing their views on board leadership, asking "**why wouldn't you separate these roles**"?

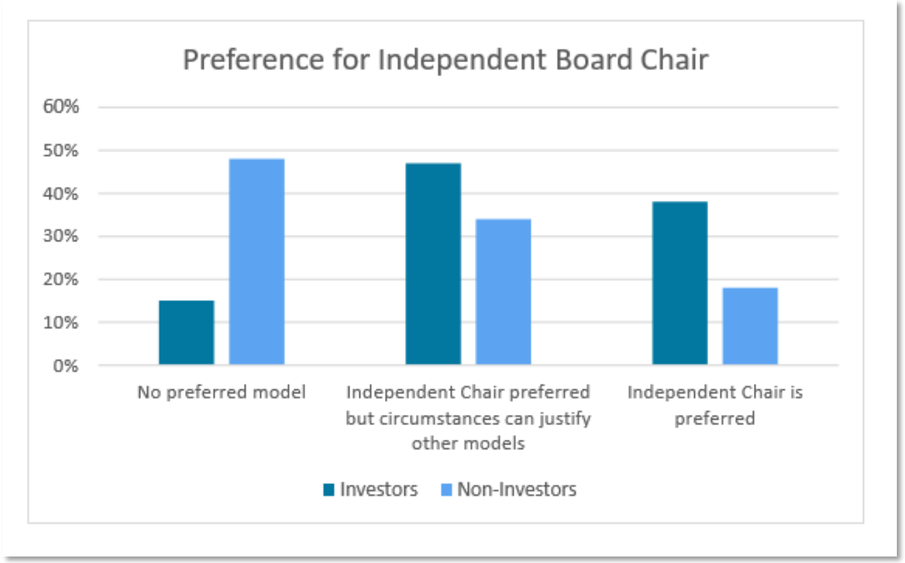


Chart 1 source: Georgeson Annual Corporate Governance Review
Chart 2 source: ISS policy survey

Continued Focus on Board Diversity

Focus on diversity shifting to racial and ethnic diversity

- In response to proposals received from the NYC Comptroller's office for inclusion in their 2020 proxy statements, approximately 12 companies adopted Rooney Rule policies with respect to directors and the CEO position
- In July, a group of NYC retirement systems sent letters to 67 S&P 100 companies that had issued public statements supportive of racial equality requesting that the companies commit by August 30 to publicly disclose their EEO-1 Report starting in 2021
- In August, State Street sent a letter to board chairs asking for expanded disclosure of their "risks, goals and strategy as related to racial and ethnic diversity"
- At the end of September the Governor of California signed a bill passed by the state legislature requiring public companies based in the state to have at least one racially, ethnically or otherwise diverse director by 2021

Overboarding

Represents a continuing challenge, with many institutional investors adopting stricter standards

- State Street revised its policy to match the four total board seat limit previously embraced by BlackRock and Vanguard for non-employee directors, and took the further step of reducing its limit to three for board chairs and LIDs
- COVID-19 has reinforced investor belief that the time demands on directors require service on fewer boards
- An increase in negative votes based on stricter overboarding policies contributed to the decrease in directors receiving 95%+ support and an increase in directors receiving 80% to 95% support

Shareholder Engagement

- Disclose in proxy the nature of prior years' engagements
  - Describe in some detail the topics discussed with investors
  - Summarize the % of outstanding shares communicated via engagement
  - Tabular or similar format
- In particular, focus on any proposal(s) that attracted negative votes
  - Proxy advisors and institutional investors will expect some description where conditions warrant (ie, significant votes against)

Action Items & Takeaways

Questions

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