Part 2

2020-21 Proxy Season Review: Disclosure and ESG

October 21, 2020

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Speakers

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Disclosure

Filer Status Definitional Changes

- Accelerated filer and large accelerated filer definitions now exclude smaller reporting companies that had annual revenues of less than $100 million in the most recent audited fiscal year
- Transition thresholds have also been increased:

Status Change	Revised Exit Threshold
LAF/AF → NAF	**Less than $60 million** in public float or qualifies as a SRC under the SRC revenue tests
LAF → AF	**$60 million or more, but less than $560 million,** in public float and does not qualify as a SRC under the SRC revenue tests

- Cover page to Form 10-K now contains a check box to indicate whether the filing includes an ICFR auditor attestation

S-K 100 Series Amendments

- August 26, 2020 – SEC adopted amendments to Reg. S-K Items 101 (Description of Business), 103 (Legal Proceedings) and 105 (Risk Factors) by a 3-2 vote
- First major revision to these rules in over 30 years
- Amendments become effective November 9, 2020
- For periodic reports, amendments will mostly affect 10-Ks, but if effective for upcoming 10-Qs, companies with greater than $30 million in consolidated current assets may want to disclose their use of a higher materiality threshold for disclosure related to environmental proceedings

S-K Item 101 (Description of Business) Amendments

General Development of Business

- Companies may choose to simply disclose material developments since a prior filing that includes a full description of the general development of the business
  - The material update approach requires incorporation by reference, with an active hyperlink, to only one registration statement or report that includes a full discussion
- Other notable changes:
  - Applied a principles-based filter (describe "only information material to an understanding of the general development of the business")
  - No longer required to state the year and form of organization
  - New prompt to disclose any material changes to a previously disclosed business strategy

S-K Item 101 (Description of Business) Amendments

Narrative Description of Business

- Principles-based approach, with number of non-exclusive disclosure prompts reduced from 12 to 7
- Eliminated dollar thresholds for revenue associated with certain classes of products
  - Dependence on certain customers remains as a disclosure prompt, but without the bright-line revenue triggers
- Expanded prompt about resources material to a company's business to include raw materials and IP
- Deleted prompt about company and industry practices relating to working capital items
  - Companies should still consider if supply chain finance agreements, or other working capital items, are material to an understanding of the company's commercial relationships beyond any discussion in MD&A

S-K Item 101 (Description of Business) Amendments

Narrative Description of Business

- Eliminated prompt regarding disclosure of backlog
- Expanded disclosure prompt regarding compliance with federal, state and local provisions beyond provisions concerning environmental laws to address all government regulations
- Added a prompt to describe human capital resources, including the number of persons employed by the company, and any human capital measures or objectives that the company focuses on in managing the business
  - To allow the term to evolve, “human capital” is undefined in the rule, and companies are not required to follow any specific standard or framework for this disclosure
  - This new requirement likely will result in the greatest change to business section disclosures

S-K Item 105 (Risk Factors) Amendments

- In addition to continuing to use subcaptions, risk factors must now be grouped under relevant headings
  - Generic risk factors, though discouraged altogether, must be grouped under the heading “**General Risk Factors**” and disclosed at the end of the risk factor section
- If the risk factor discussion exceeds **15 pages**, must now include a bulleted or numbered summary, **not in excess of 2 pages**, in the forepart of the annual report that summarizes the principal factors that make an investment in the registrant speculative or risky
  - The summary does <u>not</u> need to address all of a company’s risk factors

S-K Item 103 (Legal Proceedings) Amendments

- Recent amendments make clear that information may be provided by hyperlink or cross-reference to legal proceedings disclosure elsewhere in the document, such as MD&A, risk factors and notes to the financial statements
- Increased the $100,000 threshold for disclosure of environmental proceedings to:
  - $300,000 <u>or</u>
  - Such other threshold that the company determines is reasonably designed to result in disclosure of material proceedings
    - The alternative threshold must be disclosed each quarter <u>and</u>
    - May not exceed the lesser of (a) $1,000,000 or (b) 1% of the company's consolidated current assets

MD&A

— Companies disclosing metrics need to consider SEC guidance that became effective February 25, 2020

- Consider whether an existing disclosure framework applies (e.g., GAAP, Regulation G or Item 10 of Reg. S-K)
- Consider additional information that may be necessary to provide adequate context for investors (e.g., estimates or assumptions underlying metrics or their calculation or changes in how a metric is calculated)
- SEC guidance notes an expectation that metrics will be accompanied by:
  - Clear definition of the metric and how it is calculated
  - Statement indicating why the metric provides useful information to investors
  - Statement indicating how management uses the metric in managing/monitoring business performance
- Maintain effective disclosure controls and procedures around metrics

Accounting, Auditing, and Financial Statement Developments – PCAOB and FASB

- Critical Audit Matters (CAMs) requirements are effective for all other filers to which it applies for fiscal years ending on or after December 15, 2020
- FASB issued ASU 2020-04, which provides temporary optional guidance to ease the accounting burden associated with reference rate reform through December 31, 2022
- FASB issued ASU 2020-06, which simplifies the accounting for convertible instruments, effective for fiscal years beginning after December 15, 2021, though early adoption is permitted

Accounting, Auditing, and Financial Statement Developments – SEC

- For registered debt securities, SEC amended the financial disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered and for affiliates whose securities collateralize securities registered or being registered
  - Become mandatory on January 4, 2021, though voluntary early compliance is permitted
  - This added a new Exhibit 22 requirement for Form 10-K
- For business combinations/dispositions, the SEC significantly modified the investment and income tests for determining significance and modified the audited and pro forma financial statement requirements, among other changes
  - Become mandatory for a company's fiscal year beginning on or after January 1, 2021, though early adoption is permitted

- On October 16, 2020, the SEC amended its auditor independence rules in S-X 2-01 to modernize the rules
  - Become effective 180 days from publication in the Federal Register, though early adoption is permitted

COVID-19-Related Disclosures (Form 10-K)

- CF Disclosure Guidance: Topic No. 9 and Topic No. 9A
  - Staff encourages companies to "provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management, and that companies proactively revise and update disclosures as facts and circumstances change."
- Risk Factors
- Business
- MD&A
- Financial Statements
- Legal Proceedings
- Controls and Procedures

Proxy Statement for 2021 Annual Meeting

- CD&A: Impact of COVID-19 on executive compensation
- Pay ratio disclosure
  - Identify new median employee if you have been using the same median employee since 2017
- Perquisites
  - Enforcement actions
  - COVID-19-related perquisites
- Human capital management disclosure
- Other ESG disclosures
- Disclosure of hedging policies
  - SRCs and EGCs must now comply with this disclosure requirement

Navigating ESG Expectations

ESG Landscape Update

2020-21 WILMERHALE PROXY SEASON REVIEW

OCTOBER 21, 2020

Overview

- ESG: 2020 State of Play
- Reporting and Disclosure
- Investors and ESG
- ESG and The Board
- Articles and Resources

ESG:
2020 State of Play

THE ESG IMPERATIVE

In today's environment, a company's approach to managing Environmental, Social and Governance (ESG) factors is widely viewed by stakeholders as **an indicator of effective risk management, agility in the face of change, and the quality of the C-suite and the Board.**

To achieve success, **a company's ESG strategy must advance its business objectives**, opening up new opportunities and driving long-term financial performance.

The cost of not taking ESG seriously has become too high. Companies can no longer afford to be complacent, particularly in the face of global pandemic and persistent social unrest.

2020 is an Accelerator

Fund Flows Increasing

Investors Accelerating Activities

Policy Makers on the Move

COVID Intensifying Scrutiny

Social Issues Front and Center

Climate is a Constant

Reporting and Disclosure

Reporting Frameworks are Evolving . . .

Global Reporting Initiative (GRI)

- Standards designed to help businesses report on social, governance and environmental impacts.
- GRI is the most widely-used framework globally in ESG reporting and appeals to multiple stakeholder groups.

Sustainability Accounting Standards Board (SASB)

- Resource and framework used to identify, manage and report on ESG topics that are financially material.
- Framework focused on investor audiences.

Task Force on Climate- Related Financial Disclosures (TCFD)

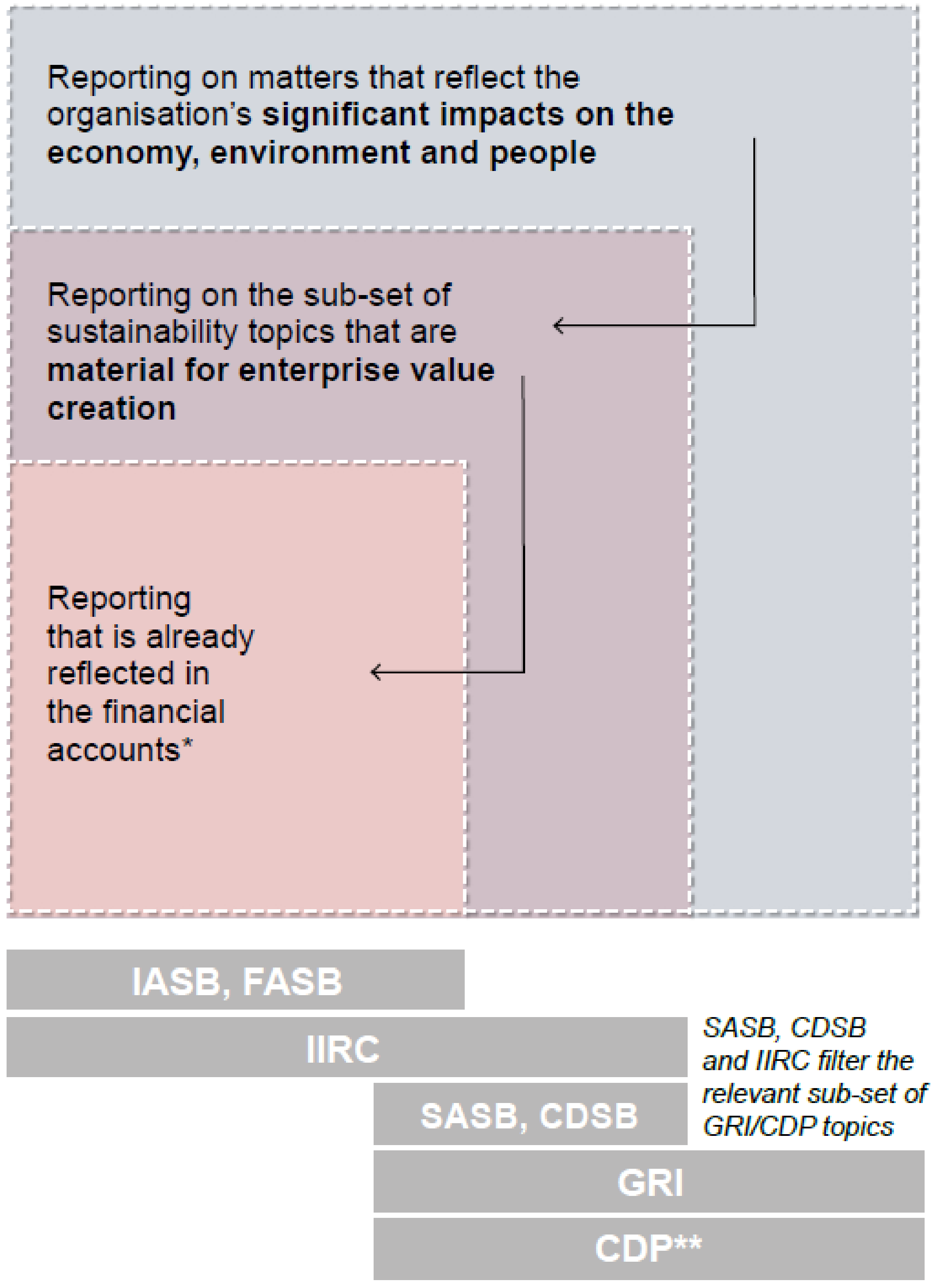
- Voluntary climate-related financial risk disclosure framework used by companies to disclose climate-related risks.
- Comprised of four pillars: Strategy, Governance, Risk and Metrics and Targets

World Economic Forum (WEF)

- A framework for investors on the signals to look for to better identify dynamic ESG issues.
- Framework highlights examples of the kinds of signals investors need to detect and analyses they should conduct

. . . But Convergence is a Long Road

THE REPORTING CONTINUUM



* Including assumptions and cash flow projections
** Reflects the scope of the CDP survey, insofar as it functions de facto as a disclosure standard for climate, water and forests, as well as the scope of CDP's data platform

- Standard-setters have announced that they are working toward a **comprehensive reporting system**, but a resolution will take time to achieve
- Large institutional investors have started to **endorse frameworks**
  - Blackrock expects companies to provide SASB and TCFD disclosures
  - State Street views SASB as best set of standards for companies
- While the TCFD standard was initially developed for climate risk disclosure, it can be **used as an overarching framework, with SASB standards sitting underneath**

Source: *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting*

ESG Ratings Impact Portfolio Construction & Change Constantly

- Higher ratings typically result from higher levels of public disclosure
- No universal standard exists – MSCI and Sustainalytics are two of dozens (but are most widely used by investors)
  - MSCI ESG indices cover ~60-80% of ESG AUM
- Discrepancies between methodologies; raters won’t share their “secret sauce”
- Addressing rating-specific criteria can be inefficient
- Ratings surveys can be cumbersome and time-consuming

Investors and ESG

Fund Flows are Increasing, Investor Activities are Accelerating

ESG investments are growing, with record inflows in Q4 2019; total ESG AUM reached $1T in Q2 2020

- **ESG integration is increasing.** In January, BlackRock announced that all $6T AUM will be governed by ESG considerations. Its July Stewardship Report identified 244 companies weak on climate change and highlighted votes against directors at 53 of those companies.
- **Investor reporting on ESG performance and active ownership activities is now the norm,** as a result of pressure from asset owner clients.
- In 2020, the **7,000 investor signatories to the Principles for Responsible Investment must disclose climate-related risks** in line with the framework developed by the Task Force for Climate-related Financial Disclosures (TCFD).
- Investors are **preparing for a $30T asset transfer to millennials**, who indicate a preference for investing in sustainable financial products.

IR magazine

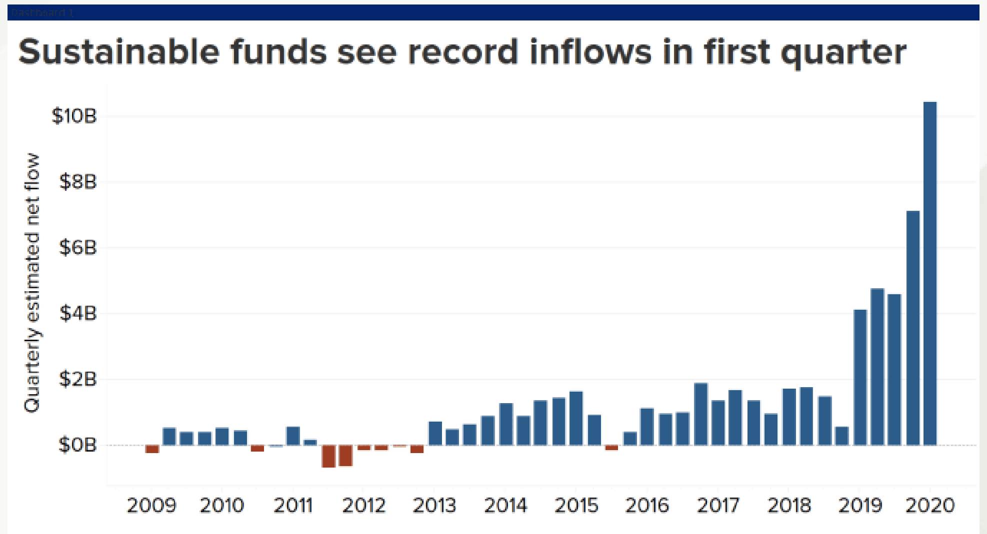
Investors' collaborative efforts accelerate, pressing IRO's to do more on ESG

EY

Institutional investors are asking tough questions about corporate ESG performance and expect answers to be embedded in corporate strategy.

INVESTMENT & PENSIONS EUROPE

PRI signatories must report climate change risks from 2020



SOURCE: Morningstar Direct, as of 3/31/2020. (ESG Integration, Impact, and Sustainable Sector funds as defined in Sustainable Funds U.S. Landscape Report, 2018. Includes liquidated funds; does not include funds of funds.

Looking Ahead: Likely Investor Priorities in 2021

CAPITAL ALLOCATION / STRATEGIC SHIFTS

SUPPLY CHAIN RESILIENCE

EXECUTIVE COMPENSATION CHANGES & STRATEGY

HUMAN CAPITAL MANAGEMENT

PROGRESS ON D&I COMMITMENTS

ESG and The Board

The Board's Role

Backdrop: fiduciary duties

Duty of Care

Act on an informed basis after due consideration of relevant materials and appropriate deliberations

Duty of Loyalty

Refrain from deriving a benefit from a transaction not generally available to all stockholders and otherwise act in good faith

Duty of Oversight*

Ensure that adequate reporting/information systems and controls exist to inform the Board of risks or non-compliance and monitor the operation of those systems

Business Judgment Rule**

Presumption that, in making business decisions, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company and its stockholders

*Care and loyalty are the two basic fiduciary duties, but the duty of oversight, which relates to the concept of good faith and therefore is under the duty of loyalty, is an important item to highlight in this context.

** A higher standard of judicial review will apply in transactional or other settings outside of the ordinary course of business. These higher standards are beyond the scope of this presentation.

Board ESG Accountabilities

- **Establish Board oversight structure.** Decide whether to assign oversight to the full board or to specific committees on and issue-by-issue basis (practices vary). Reflect the structure in Board governance documents.

- **Determine frequency of updates.** How often does the Board receive updates on ESG strategy and performance? Key items for review include:
    - Strategic shifts – annual
    - Progress updates – mid-year and year-end
    - Investor priorities and engagement – pre- and post-proxy season
    - Reporting and disclosure – annual

- **Understand ESG risks and opportunities.** Are ESG strategy and activities connected to the business strategy? Is ESG integrated into the company's enterprise risk management activities?

- **Understand management-level accountabilities.** Who within the company is responsible for ESG management, performance, and disclosure?

- **Select a Director to speak externally on ESG.** Some investors may want to speak with the Board directly.

- **Ensure inclusion in reporting and disclosure.** Investors want to see that ESG oversight is integrated into the Board's governance accountabilities.

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Action Items and Key Takeaways

Document Updates to Consider

- D&O Questionnaire
  - Reflect change in Nasdaq definition of “family member”
  - Consider adding questions to support disclosures about board diversity
  - Eliminate 162(m) questions if no grandfathered awards remain
- Compensation Committee Charter
  - Consider addressing committee’s activities regarding human capital
  - Eliminate 162(m) questions if no grandfathered awards remain
- Nominating/Governance Committee Charter
  - Consider addressing committee’s oversight of ESG issues
- Audit Committee Charter
  - Consider addressing oversight duties regarding cybersecurity
- Exhibits
  - Consider whether any charter or bylaw amendments or issuances, maturities, redemptions, cancellations or other events have occurred that need to be updated in Exhibit 4
  - Consider for any registered securities whether Exhibit 22 is required, which lists each issuer, co-issuer, or guarantor of a guaranteed security, and each entity that is an affiliate of the registrant whose security is pledged as collateral for a registrant’s security

Questions

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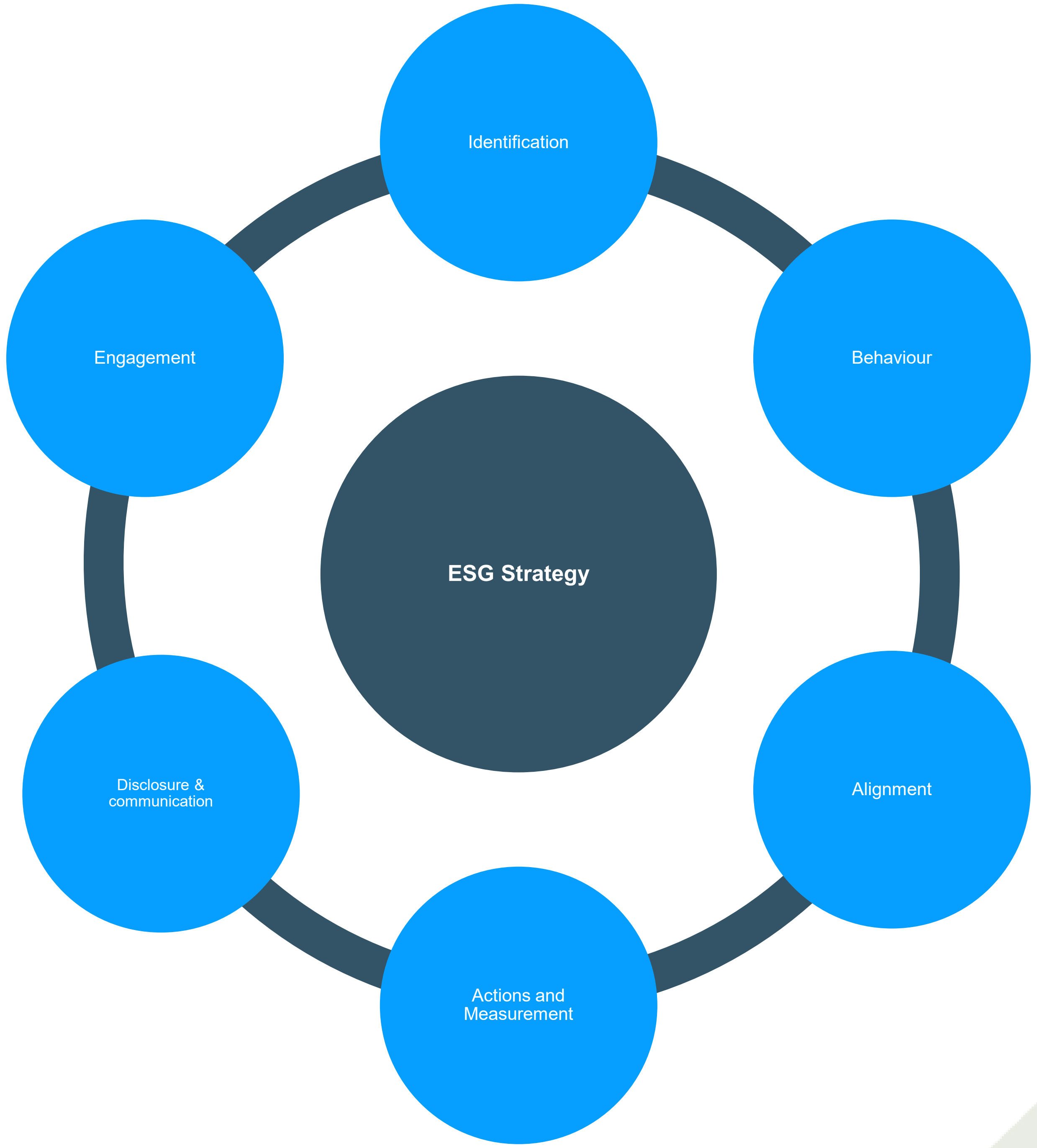
Supplemental Materials

Building a Successful, Long-term ESG Strategy

A successful ESG strategy should:

- Set out a clear corporate purpose and ESG goals, backed by defined KPIs
- Be aligned to the most relevant and globally supported frameworks and standards
- Generate greater recognition of ESG performance from internal and external stakeholders through transparent disclosure and communications
- Be integrated with brand narrative and financial reporting
- Demonstrate an appropriate level of oversight and accountability
- Improve ESG rating agency scores and enhance the overall investment case



The ESG Imperative Checklist

- ❑ **Purpose Statement.** Develop a crisp, clear corporate purpose statement. Ensure that it is broadly understood across the organization.
- ❑ **ESG Strategy.** Identify ESG priorities for the business. Construct a roadmap for execution.
- ❑ **Accountability.** Confirm that the right people are accountable for making progress.
- ❑ **Governance.** Establish C-suite and Board-level oversight mechanisms.
- ❑ **Stakeholders.** Build strong, two-way communications channels with investors and other stakeholders.
- ❑ **Employees.** Embed ESG into the company's employee value proposition. Give employees a voice in setting the agenda.
- ❑ **Partnerships.** Consider developing partnerships with non-governmental organizations (NGOs) to inform and advance your ESG goals.
- ❑ **Reporting.** Make sure the company's ESG reporting follows a disclosure framework endorsed by investors.
- ❑ **Communications.** Provide a consistent ESG narrative and messaging across all communications channels.
- ❑ **Taking a Stand.** Identify any ESG issues on which your company can adopt a powerful public position.

Best Practices for ESG Reporting

DO:

- ✓ Set objectives and audiences
- ✓ Emphasize long-term strategy
- ✓ Balance data and storytelling
- ✓ Make form follow function
- ✓ Implement a digital strategy
- ✓ Speak honestly and transparently
- ✓ Use dynamic graphics
- ✓ Follow an accepted standard or framework

DON'T:

- × Ignore stakeholder priorities
- × Minimize project management
- × Allow numbers/anecdotes to overwhelm strategic narrative
- × Make function follow form
- × Change frameworks/KPIs each cycle
- × Hide failures, use jargon/marketing spin
- × Use words when visuals will do
- × Omit material ESG issues and topics

Articles and Resources

Harvard Corporate Governance Forum: Stockholders Versus Stakeholders—Cutting the Gordian Knot

SEC (Human Capital Management): SEC Refreshes Its Business, Legal Proceeding and Risk Factor Disclosure Requirements *(WilmerHale memo)*

DFIN: Example ESG Disclosures in DFIN's Guide to Effective Proxies

SASB: Example SASB Disclosures

Impact Management Project, World Economic Forum and Deloitte: Statement of Intent to Work Together Towards Comprehensive Corporate Reporting

BlackRock: Highlights from the BlackRock Future Forum; 2020 Annual Stewardship Report

State Street (Diversity): Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies

Edelman: 2019 Investor Trust Barometer Survey *(2020 to launch November 17th)*

CFA Institute: Consultation Paper on ESG Disclosure Standards for Investment Products