Matters To Consider for the 2022 Annual Meeting and Reporting Season

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Companies have important decisions to make as they prepare for the 2022 annual meeting and reporting season.

We have compiled this overview of key issues — including SEC disclosure requirements, recent SEC guidance, executive compensation considerations and annual meeting and corporate governance trends — on which we believe companies should focus as they plan for the upcoming season. As always, we welcome any questions you have on these topics or other areas related to annual meeting and reporting matters.

Checklist of Matters To Consider for the 2022 Annual Meeting and Reporting Season

SEC Disclosure Requirements

Recent SEC Guidance

Executive Compensation Considerations

Annual Meeting and Corporate Governance Trends

Consider Recent MD&A Amendments

As discussed in our November 25, 2020, client alert "SEC Amends MD&A and Other Financial Disclosure Requirements," in November 2020, the U.S. Securities and Exchange Commission (SEC) adopted amendments to Regulation S-K Items 301, 302 and 303 to move from a prescription-based disclosure framework for certain financial disclosures toward a principles-based one, emphasizing a company-specific assessment and discussion of material information. The SEC also adopted conforming amendments applicable to foreign private issuers, including to disclosures on Forms 20-F and 40-F.

Although early compliance has been permitted, compliance with the amended rules is required for the first fiscal year ending on or after August 9, 2021. As a result, for calendar year-end companies, the new rules will apply to annual reports for the fiscal year ending December 31, 2021 and other periodic reports going forward. The amendments are discussed below, along with practical takeaways for issuers.

Item 301 (Selected Financial Data). Item 301 previously required registrants to present up to five years of selected financial data in a tabular format. The amendments completely eliminated this requirement, although the SEC noted that material trends disclosure that dates beyond the period where financial statements are provided may continue to be helpful to investors and that tabular disclosure of this selected financial information, even though not required under the new rules, may remain a helpful way of communicating these trends to investors depending on the registrant.

Takeaway: Remove Item 6 disclosure from Form 10-K and consider whether any trend information for periods earlier than those presented in financial statements might be helpful in management's discussion and analysis of financial condition and results of operations (MD&A).

Item 302 (Supplementary Financial Data). Previously, Item 302(a)(1) required certain registrants to disclose selected quarterly financial data of specified operating results (such as net sales, gross profit and net income) for at least the past two years, and Item 302(a)(2) required disclosure of variances in these results from amounts previously reported on a Form 10-Q. Under the amended rules, disclosure of supplementary financial information will be required only when there are one or more retrospective changes that pertain to the financial statements for any of the quarters within the two most recent fiscal years that, individually or in the aggregate, are material. In such cases, registrants would provide an explanation of the reasons for the material changes and disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information and earnings per share reflecting such changes.

Takeaway: Consider whether supplementary financial data under Item 8 should be removed. If there was a material retrospective change or changes for any quarter within the two most recent fiscal years and any subsequent interim period, provide an explanation of the change and select financial information reflecting the change.

Item 303 (MD&A). The amendments resulted in a number of changes to Regulation S-K Item 303. Previously, Item 303 contained subparts (a) and (b), which contained disclosure requirements for full fiscal years and interim periods, respectively. Item 303 was revised to add a new subpart (a) and move the full fiscal year requirements to subpart (b) and the interim period requirements to subpart (c).

Item 303(a) (Objectives). The amendments add a new first paragraph to Item 303 that explains the overarching requirements of MD&A for both full fiscal years and interim periods. The objective section incorporates much of the substance of Item 303's prior instructions and codifies SEC guidance that MD&A should enable investors to view the company from management's perspective. New Item 303(a) specifically requires that companies disclose:

- Material information relevant to an assessment of the company's financial condition and results of operations, including an evaluation of the amounts and certainty of cash flows from operations and from outside sources.
- Material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be indicative of future operating results or of future financial condition.
  - This includes descriptions and amounts of matters that have had a material impact on reported operations as well as matters that are reasonably likely, based on management's assessment, to have a material impact on future operations.
- Material financial and statistical data that the company believes will enhance a reader's understanding of the company's financial condition, cash flows and other changes in financial condition, and results of operations.

The SEC encourages companies to revisit this objective as they prepare MD&A.

Takeaway: While the new objective largely codifies previous guidance and may not result in any disclosure changes, consider whether there are any material events and uncertainties known to management that are reasonably likely to have a material impact on future operations.

Item 303(b) (Full Fiscal Years). Amended Item 303(b) focuses on disclosure for full fiscal years and contains three main components: (i) liquidity and capital resources, (ii) results of operations and (iii) critical accounting estimates.

- **303(b)(1) (Liquidity and Capital Resources).** Item 303(a)(2) previously required registrants to discuss material commitments for capital expenditures as of the end of the latest fiscal period and to indicate the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments. Amended Item 303(b)(1) expands this to specifically require disclosure of known material cash requirements, including, but not limited to, commitments for capital expenditures. The amendments retained the requirement to describe known material trends in capital resources, but now require companies to indicate any "reasonably likely" material changes in the mix and cost of such resources, as opposed to expected material changes.

Takeaway: Consider whether MD&A adequately addresses all known material cash requirements, including those not necessarily related to capital investments in property, plant and equipment but also human capital, intellectual property, contractual obligations, off-balance sheet arrangements and other similar requirements. Describe material trends, demands, commitments, events or uncertainties that are reasonably likely to affect liquidity and capital resources — not only those that are expected to impact liquidity and capital resources.

- **303(b)(2) (Results of Operations).** The amendments require registrants to disclose events that are reasonably likely to (as opposed to events that "will" or that the company "reasonably expects will") have a material impact on revenue/income or cause a material change in the relationship between costs and revenues. The amendments also codify past guidance and specify that discussion of changes in price/volume and new products is required whenever there are "material changes" to revenue, rather than simply when there are "material increases" in revenue. Specifically, the amendments change the requirement that a registrant disclose material increases in net sales and revenues to one that the registrant disclose material changes (whether increases or decreases) in net sales and revenues. In addition, the amendments eliminate the requirement that registrants specifically disclose the impact of inflation and price changes on their net sales, revenue and income from continuing operations to the extent material. Registrants will still be required to discuss the impact of inflation and prices, if material.

Takeaway: Ensure MD&A addresses known trends or uncertainties if they are reasonably likely to occur and would be material. Consider and address whether there have been any material changes, rather than just increases, in net sales or revenues.

- **303(b)(3) (Critical Accounting Estimates).** The amendments codify past guidance and require companies to provide qualitative and quantitative disclosure necessary to understand the uncertainty and impact a critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations of the company, including why each estimate is subject to uncertainty. This disclosure is only required to the extent the information is material and reasonably available, and should include "[(i)] how much each estimate and/or assumption has changed over a relevant period, and [(ii)] the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation."

Takeaway: Address critical accounting estimates (CAE) in MD&A, including, to the extent material and reasonably available, why the CAE is subject to uncertainty, how much the CAE or assumption (or both) has changed during the relevant period and the sensitivity of reported amounts to the methods, assumptions and estimates underlying the CAE's calculation.

- **Off-Balance Sheet Arrangements.** The amendments eliminate the requirement to present a separately captioned section discussing off-balance sheet arrangements and instead add a principles-based instruction to discuss certain commitments or obligations (including those formerly disclosed as off-balance sheet arrangements).

Takeaway: Remove separately captioned off-balance sheet arrangements section, but consider whether disclosure is required in liquidity and capital resources.

- **Contractual Obligations.** The amendments eliminate the requirement to present a contractual obligations table. Instead of the table, companies should disclose material cash requirements generally, including capital expenditures and known contractual obligations.

Takeaway: Remove the contractual obligations table, but consider whether any disclosure is required in liquidity and capital resources.

- **Interim Periods.** Item 303(b) previously required companies to provide MD&A disclosure for interim periods that enabled market participants to assess material changes in financial condition and results of operations between certain specified periods. The amendments permit companies to compare their most recently completed quarter to either the corresponding quarter of the prior year (as currently required) or the immediately preceding quarter. If a company elects to discuss changes from the immediately preceding quarter, it will be required to provide summary financial information that is the subject of the discussion for that quarter or identify the prior EDGAR filing that presents such information so investors have ready access to the relevant prior quarter financial information. If a company changes the comparison from the prior interim period comparison, it will be required to explain the reason for the change and present both comparisons in the filing where the change is announced.

Takeaway: Consider whether to revise the approach to MD&A in quarterly reports going forward, and if changing from prior interim period, explain the reason for the change.

Comply With Other Updated SEC Filings Requirements

Disclosures for Issuers With Auditors Not Subject to PCAOB Inspection

In December 2021, the SEC adopted final rules to implement congressionally mandated submission and disclosure requirements of the Holding Foreign Companies Accountable Act (HFCA Act).[1] The amendments apply to registrants that the SEC identifies (SEC-identified issuers) as having filed an annual report on Forms 10-K, 20-F, 40-F or N-CSR with an audit report issued by a registered public accounting firm (i) that is located in a foreign jurisdiction and (ii) that the Public Company Accounting Oversight Board (PCAOB) has determined it is unable to inspect or investigate completely because of a position taken by an authority in that jurisdiction. In addition, the adopting release establishes the SEC's procedures for (i) determining whether a registrant is an SEC-identified issuer and (ii) prohibiting the trading of an SEC-identified issuer's securities pursuant to the HFCA Act. In November 2021, the SEC approved PCAOB Rule 6100, which establishes the framework for the PCAOB's determinations under the HFCA Act.[2]

The final amendments will go into effect 30 days after publication in the Federal Register. The earliest that the SEC could identify an SEC-identified issuer would be after companies file their annual reports for 2021 (*i.e.*, spring 2022 for calendar-year issuers). A registrant will be required to provide this disclosure for each year in which it is an SEC-identified issuer that is also a foreign issuer. The earliest any trading prohibitions would apply would be in 2024, once an issuer has been an SEC-identified issuer for three consecutive years (2022, 2023 and 2024). SEC-identified issuers that are foreign issuers, as defined in Exchange Act Rule 3b-4, must make a number of additional specified disclosures in their annual report on Forms 10-K, 20-F, 40-F and N-CSR (as the case may be):

- the registered public accounting firm that caused the issuer to be identified as an SEC-identified issuer during the period covered by the form;
- the percentage of shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized;
- whether governmental entities in the applicable foreign jurisdiction with respect to the registered public accounting firm have a controlling financial interest with respect to the issuer;
- the name of each official of the Chinese Communist Party who is a member of the board of directors of the issuer or the operating entity with respect to the issuer; and
- whether the articles of incorporation of the issuer (or equivalent organizing document) contain any charter of the Chinese Communist Party, including the text of any such charter.

In addition, the issuer must look through a variable-interest entity or any structure that results in additional foreign entities being consolidated in its financial statements and provide the required disclosures about any consolidated operating company or companies in the relevant jurisdiction. Generally, SEC-identified issuers (*i.e.*, not just foreign issuers) also are required to submit documentation to the SEC via EDGAR on or before the annual report due date that establishes that they are not owned or controlled by a governmental entity in that foreign jurisdiction.

Resource Extraction Payments Disclosure

The SEC adopted final rule amendments, effective March 16, 2021, which require certain publicly reporting oil, natural gas and mineral companies to disclose payments made to

[1] See our client alert "SEC Adopts Final Amendments Implementing Mandates of the Holding Foreign Companies Accountable Act" (December 4, 2021)

[2] See our client alert "SEC Approves PCAOB Rule Establishing Framework for Determinations Under the Holding Foreign Companies Accountable Act" (November 8, 2021).

the U.S. federal government or to foreign governments for the commercial development of oil, natural gas or minerals.

The amendments are applicable to all "resource extraction issuers," which includes all U.S. and foreign issuers (including Canadian companies reporting through the multijurisdictional disclosure system) that (i) are required to file an annual report with the SEC on Form 10-K, 20-F or 40-F, and (ii) engage in the commercial development of oil, natural gas or minerals. Commercial development includes exploration, extraction, processing and export of oil, natural gas or minerals or the acquisition of a license for any such activity. Smaller reporting companies and emerging growth companies are exempt from the final rules unless they are subject to an alternative reporting regime, such as the EU or Canadian reporting requirements.

Companies will be required to furnish to the SEC the required disclosure annually on Form SD no later than 270 days following the end of their most recently completed fiscal year, subject to certain exemptions, transitional relief or compliant alternative reporting. The required disclosure must be submitted on EDGAR in an XBRL exhibit to Form SD. Note, the final rule amendments include a generous two-year transition period. As a result, companies will be required to comply with the new annual reporting requirement starting with their fiscal year ending no earlier than two years after the effective date of the final rules.

Changes to Standards for Redacting Exhibits

The SEC updated the standard for redacting confidential information in exhibit filings pursuant to Regulation S-K Items 601(b)(2) and 601(b)(10), and parallel provisions in Form 20-F, to align with a 2019 U.S. Supreme Court interpretation of the Freedom of Information Act.[3] The final rule amendments, effective as of March 15, 2021, remove the "competitive harm" standard and permit information to be redacted if it is not material and is the type that the company both customarily and actually treats as private or confidential.

Changes to Standards for Electronic Signatures

The SEC eased the requirement to obtain a "wet" signature authorizing the inclusion of a conformed signature in documents filed on EDGAR. The final rule amendments, effective December 4, 2020, permit the use of electronic signatures in authentication documents required under Regulation S-T in connection with EDGAR filings that are required to be signed.[4] Note, before a signatory initially uses an electronic signature to sign an authentication document, the signatory must manually sign "a document attesting that the signatory agrees that the use of an electronic signature in any authentication document constitutes the legal equivalent of such individual's manual signature for purposes of authenticating the signature to any filing for which it is provided."

The final rule amendments permit the use of electronic signatures in connection with, among others, annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; Exchange Act Section 16 forms; registration statements on Forms S-1, S-3 and S-8; and foreign private issuer filings, such as Form 20-F.

Potential Exchange Act Disclosure Arising From Russia Sanctions

In response to a number of activities allegedly undertaken by Russia, the U.S. government has imposed a series of additional sanctions and export control measures since early March 2021. Publicly reporting companies doing business with or in Russia should consider responsive disclosure pursuant to Exchange Act Section 13(r)(1)(D) as a collateral effect of certain of the additional sanctions.

Insofar as relevant here, the additional sanctions added Russia's Federal Security Service (FSB), which already was under separate U.S. sanctions, to the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC) list of Specially Designated Nationals and Blocked Persons. Russia's FSB plays an integral role in the regulatory process regarding importation of information technology and other encryption products into Russia. Thus, companies often are required to interact with the FSB in some capacity if they transact in these covered items. For example, companies transacting in laptops and smartphones, connected cars, medical devices, software or any other items that make use of ordinary commercial encryption may have to notify or seek approval from the FSB if they import or use such items in Russia.

OFAC previously has recognized the challenge the FSB's role could pose for companies doing business in Russia, and issued Cyber General License 1B, which authorizes certain activities connected to the FSB's regulatory role. SEC reporting companies, however, must be cognizant of the fact that there is no exception or exclusion from the SEC reporting requirements for transactions that are authorized. Thus, even if General License 1B authorizes a party's transaction with the FSB from a U.S. sanctions perspective, the knowing conduct of such a transaction must be reported to the SEC if the party is a publicly reporting company under the U.S. securities laws. Moreover, because the reporting extends to activities of affiliates of issuers, it is important to ensure that the activities of non-U.S. parties with the FSB are also accounted for.

[3] See *Food Marketing Institute v. Argus Leader Media*, 139 S.Ct. 2356 (2019).

[4] See our client alert "SEC Adopts Rules To Allow Use of Electronic Signatures" (November 20, 2020).

Reassess Risk Factors

Risk factor disclosure remains a critical piece of periodic reports. Companies must continually monitor recent developments and ensure their risk factor disclosure is accurate and up to date. The following is a discussion of considerations for companies to keep in mind when assessing their risk factor disclosure for upcoming filings.

As a reminder, in 2020, the SEC amended the risk factors disclosure requirements under Regulation S-K Item 105. The amendments require a company to disclose the "material" factors that make an investment in the company risky. Risk factors must be organized under relevant headings and disclosing risk factors that could apply generically to any company is discouraged. In addition, if a company's risk factors disclosure exceeds 15 pages, the company must include a bulleted risk factor summary not longer than two pages.

Recent Developments To Consider

Companies should consider the following recent developments when assessing and preparing their risk factor disclosure for upcoming filings:

- **LIBOR Transition.** In March 2021, the ICE Benchmark Administration Limited, which administers the London Interbank Offered Rate (LIBOR), confirmed its intention to cease publication of short-term USD LIBOR tenors and all non-USD LIBOR tenors after December 31, 2021, and all-other USD LIBOR tenors after June 30, 2023. Recent comments from U.S. regulators have indicated that there will not be a reversal of this course. Accordingly, companies with financial instruments that rely on LIBOR as a benchmark should evaluate the implications of LIBOR's discontinuation, including the related material risks. In addition, previously disclosed risk factors that speak of LIBOR's discontinuation in the hypothetical should be revised to make clear that LIBOR will, indeed, cease to exist.
- **COVID-19 Vaccine Mandates.** In September 2021, President Joe Biden signed an executive order that will require all federal contractors to ensure their U.S.-based employees, contractors, and subcontractors servicing such contracts are fully vaccinated. In addition, President Biden directed the Department of Labor's Occupational Safety and Health Administration to develop a rule requiring all employers with at least 100 employees to ensure that their employees are fully vaccinated or require unvaccinated workers to produce a negative COVID-19 test on a weekly basis. Companies should evaluate the potential impact of these developments, which may include increased costs and employee disruption and attrition.
- **Supply Chain Disruptions.** Companies should consider the impact of recent supply chain disruptions, including the global microchip shortage, on their business. Potential adverse impacts to certain companies may include, among others, increased costs, inventory shortages, shipping and project completion delays, and inability to meet customer demand.
- **Climate Change.** As discussed in the section titled "Consider Impact of Climate Change and ESG in Company Disclosures," the SEC has recently enhanced its focus on climate-related disclosures. Companies should evaluate their disclosure obligations concerning climate change matters, including risks associated with climate change, by reviewing the SEC's interpretive release "Commission Guidance Regarding Disclosure Related to Climate Change" (February 2, 2010) and considering whether any updates are relevant or necessary.

In addition, companies should remember that risks should not be presented as hypothetical when they are, in fact, occurring.[5] Companies should also assess any other significant risks to their business and industry when preparing their annual report filings, in addition to assessing any material changes to existing risk factor disclosures on a quarterly basis.

[5] See, *e.g.*, the SEC's press release "SEC Charges Pearson plc for Misleading Investors About Cyber Breach" (August 16, 2021).

Prepare Human Capital Disclosures in Light of Recent Disclosure Trends and Developments

The past reporting season took companies into unfamiliar waters as they became subject to the SEC's new human capital disclosure requirement for the first time. In preparing human capital disclosure for the upcoming reporting season, companies should be mindful of recent disclosure trends and other considerations discussed below.

Background

The SEC's most recent amendments to Regulation S-K Item 101(c), which became effective in November 2020, introduced new human capital disclosure requirements applicable to Form 10-K and other SEC filings. Specifically, the amendments require, to the extent material to an understanding of the company's business as a whole, a description of (i) the company's human capital resources, including the number of employees, and (ii) any human capital measures or objectives that the company focuses on in managing the business, including those that address the development, attraction and retention of personnel. In adopting this principles-based rule, the SEC declined to define "human capital" or require disclosure of any specific metrics beyond the number of employees.[6]

Disclosure Trends

During the first year of compliance, company disclosures varied in length and scope to address the principles-based rule. Companies should consider these trends, as well as benchmarking their peers, in preparing their human capital disclosure for the upcoming reporting season. A recent Intelligize survey of Form 10-K filings by S&P 500 companies indicates that while over 89% of the companies surveyed generally discussed the following key topics in their human capital disclosures, quantitative metrics were much less common:[7]

- *Diversity & inclusion* (D&I), of which more than 60% gave D&I its own heading. However, most declined to provide specific metrics, with only 4% disclosing EEO-1 demographic workforce data in their Form 10-K. With that said, 48% of Fortune 100 companies disclosed in their proxy statements that they are committed to disclosing or already publicly report EEO-1-aligned data.[8]
- *Health- and safety-related issues*, including company wellness programs, employee assistance programs, safety enhancements, workplace injuries and continuity planning in connection with a transition to remote working. Not surprisingly, COVID-19 was a common theme. In addition, over a quarter of companies surveyed combined the discussion of health and safety.
- *Workforce compensation*, although most companies emphasized the less quantifiable aspects of their compensation programs, such as benefits and incentive plans, rather than disclosing specific compensation figures.
- *Company culture or values*, often focusing on employee engagement, codes of conduct, core principles and commitment to ethical behavior. Nearly half of companies surveyed also disclosed select results from some form of an employee engagement survey, indicating that companies were more comfortable providing quantitative disclosures on employee engagement than other topics, such as D&I.

The survey also notes that a majority of companies surveyed discuss other topics, including:

- *Community involvement,* which 77% discussed. Common topics included company-designated volunteer days, charitable contribution matching programs and employee volunteer programs.

[6] See the SEC's adopting release "Modernization of Regulation S-K Items 101, 103 and 105" (August 26, 2020).

[7] Intelligize analyzed 427 Form 10-Ks filed by S&P 500 companies between November 9, 2020, and March 5, 2021.

[8] See Ernst & Young's "What Boards Should Know About ESG Developments in the 2021 Proxy Season" (August 3, 2021).

- *Employee training, recruiting and retention*, which over half of companies discussed. A third of companies also discussed employee turnover. Generally, such discussions were qualitative-focused, with few companies providing specific quantitative metrics, such as employee turnover rates.

Other Practical Considerations

In addition to recent disclosure trends, companies may consider the following guidance and recommendations when preparing human capital disclosures in upcoming filings.

Reassess Existing Disclosure. Reassess the company's existing human capital disclosures in prior SEC filings; corporate responsibility and/or environmental, social and governance (ESG) reports; the corporate website; and other publicly available sources. In addition, companies should consider any updates to corresponding human capital disclosures in upcoming proxy statements and/or ESG reports, which companies typically file or publish after filing the Form 10-K. Companies should ensure that the discussion in the Form 10-K aligns with any corresponding disclosures in other reports and communications.

Determine Scope of Upcoming Disclosure. Coordinate with relevant internal stakeholders early in the process to identify any new key strategic objectives and measures and to determine the scope of material human capital topics. In determining the scope of topics to be disclosed in the Form 10-K, companies should also consider disclosing any progress that management has made with respect to any objectives it has set regarding its human capital resources. Internal coordination may be required to monitor, collect and verify data for any metrics and other quantitative measures. Such discussions would typically involve members of the legal, human resources and investor relations teams, as well as senior management and the disclosure committee. See the section titled "Reassess Disclosure Controls and Procedures" for additional information.

Reassess Quantitative Measures. Reassess whether any quantitative measures — such as full-time employees, part-time employees, independent contractors and contingent workers, as well as employee turnover — are material to an understanding of the company's business and should be disclosed. In addition, confirm that any quantitative measures are defined and calculated consistently from period to period or disclose any changes to the methodology. Note that the SEC is expected to propose new rules that could require disclosure of additional human capital metrics, as discussed in the section titled "Consider Status of Recent and Pending SEC Rulemaking Matters." However, any such rules, if proposed, would be subject to a public comment period and final adoption and therefore not apply to disclosures for the upcoming annual reporting season.

Consider Differences in Reporting Standards. Companies that follow specific ESG reporting frameworks, such as the Sustainability Accounting Standards Board (SASB), should be aware that materiality may be defined differently under such frameworks versus various SEC rules and also consider any relevant guidance published by the relevant ESG reporting framework.[9]

Consider Recent Guidance From Institutional Investors. Consider institutional investor voting guidelines related to human capital disclosure. For example, BlackRock expects companies to disclose workforce demographics (such as gender, race and ethnicity) and the steps that they are taking to advance diversity, equity and inclusion.[10] Similarly, State Street expects all companies in its portfolio to disclose measures of employee diversity by race, ethnicity and gender, broken down by industry relevant employment categories or levels of seniority, for all full-time employees.[11] Companies should be prepared to discuss their human capital management strategies in engagement sessions with investors and consider the appropriate location of any related disclosures in the Form 10-K, proxy statement, ESG report and other forms of disclosures. See the section titled "Consider Shareholder Proposal Trends and Developments" for additional information.

[9] See, *e.g.*, SASB's "Human Capital Bulletin" (November 2020).

[10] See BlackRock's "Proxy Voting Guidelines for U.S. Securities" (December 2020).

[11] See State Street's "Guidance on Enhancing Racial & Ethnic Diversity Disclosures" (January 2021).

Note Status of Recent and Pending SEC Rulemaking Matters

With a new administration and SEC leadership, rulemaking priorities shifted in 2021 as compared to the previous year. Under SEC Chair Gary Gensler, the SEC put forth a robust regulatory agenda, as well as new guidance on several key topics. Significant SEC regulatory developments are summarized below.

Filing Fee Modernization. In October 2021, the SEC announced the adoption of final amendments[12] to the rules governing the payment of filing fees by companies engaged in certain transactions, including registered securities offerings, tender offers, and mergers and acquisitions. The amendments are comprehensive and revise most fee-bearing forms, schedules and the related rules. The amendments made significant changes to how companies disclose, file and pay filing fees. First, the amended rule requires registrants to present the filing fee table in tabular form, using Inline XBRL. The new filing fee table requires additional columns of information to be presented, including the type of security to be registered, the registration form type, the file number, the initial effective date of the registration statement associated with any unsold securities that the registrant is carrying forward, and the total fee due net of any offsets and fees previously paid.

Second, registrants must file the fee table as a separate exhibit to the registration statement or post-effective amendment. Information relevant to calculation of the filing fee (such as offsets and carryforwards from prior offerings) may not be incorporated by reference, but should be included as part of the exhibit.

Third, registrants will be able to pay filing fees via Automated Clearing House, credit and/or debit cards. Payment by check or money order no longer will be accepted. The amended final rule is effective as of January 31, 2022, apart from the amendments related to payment methods, which will be effective on May 31, 2022. After the fee disclosure rules take effect in January 2022, registrants will benefit from a transition period. Large accelerated filers will be required to comply with the new fee disclosure requirements in filings submitted more than 30 months after the rule becomes effective. Accelerated filers and all other filers will be required to comply after 42 months. Voluntary early compliance by any registrant will be permitted as soon as the EDGAR system has been modified to accept fee disclosures in Inline XBRL format, which is estimated to occur by early 2023.

Reopening of Comment Period for Clawback Rules. In October 2021, the SEC reopened the comment period on proposed rules regarding the recovery of erroneously awarded compensation, which suggested that the SEC is considering broadening the rules.[13] The reopened comment period allows the public to submit further comments and data on rule amendments the SEC first proposed in 2015 to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The proposed rules would instruct national securities exchanges to establish listing standards that require issuers to adopt, disclose and comply with a specific compensation clawback policy as a condition to listing. Such compensation clawback policy would enable issuers to recover from current and former executive officers erroneously awarded incentive-based compensation received during the three fiscal years preceding the date of an accounting restatement required to correct a material error in the issuer's financial statements. The proposed rule includes a no-fault mandate, meaning that an issuer's ability to recover incentive-based compensation from a current or former executive officer does not hinge on the individual's responsibility for the financial misstatement(s) or engagement in misconduct. In addition, the proposed rules would require

[12] See the SEC's adopting release "Filing Fee Disclosure and Payment Methods Modernization" (October 13, 2021).

[13] See the SEC's reopening release "Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation" (October 14, 2021).

issuers to provide disclosure about the recovery of excess incentive-based compensation and its clawback policy. In reopening the request for comments, the SEC is seeking additional information on, among other things, how broadly the SEC should interpret "restatement" under the Dodd-Frank Act (*i.e.*, whether it should encompass little "r" restatements), whether the SEC should add check boxes to Form 10-K regarding previous financial statement error correction and any accompanying clawback analysis, and the costs and benefits of clawback policies. For further background on and discussion regarding the clawback rules, see the section titled "Note Status of Pending SEC Rulemaking Relating to Clawback Policies Under Dodd-Frank."

Rule 10b5-1 Plans and Share Repurchases. The SEC expects to propose rule amendments in the coming months in response to increasing scrutiny of insider trading practices by individuals and issuers. Proposed rules would amend Exchange Act Rule 10b5-1, which provides an affirmative defense against insider trading liability for trades by individuals and share repurchases by issuers if they are made pursuant to a written plan entered into when the individual or issuer did not possess material nonpublic information about the company or securities traded. Chair Gensler has identified several areas of focus for SEC staff with respect to Rule 10b5-1, including consideration of mandatory cooling-off periods, potential liability upon plan termination, public disclosure of 10b5-1 plans and limits on the number of 10b5-1 plans an insider may adopt. The SEC Investor Advisory Committee also urged the SEC to adopt mandatory cooling-off periods and prohibit an insider from having more than one 10b5-1 plan in effect at any given time.[14] For further detail on the Investor Advisory Committee's recommendation, see the section titled "Revisit Internal Procedures Relating to Cybersecurity and Insider Trading." In addition, the SEC is expected to consider proposed amendments to modernize issuer share repurchase disclosure requirements, including potential amendments to Regulation S-K Item 703, which requires issuers to provide a monthly tabulation of repurchases in their periodic reports.

Proxy Rules Reform. The SEC recently considered several potential amendments to the proxy rules. On November 17, 2021, the SEC adopted rules mandating the use of universal proxy cards in contested elections. Requiring that the names of all nominees appear in both the company's proxy card and the dissident's proxy card will permit shareholders to "mix and match" from the competing slates of candidates without having to attend the shareholder meeting. The new rules take effect for shareholder meetings held after August 31, 2022, and will not apply to elections held by registered investment companies and business development companies. Further, the SEC proposed amendments to the rules governing proxy advisors. The amendments would rescind two portions of the proxy rules adopted in 2020 governing (i) the exemptions from the proxy information and filing requirements and (ii) a note setting forth nonexclusive examples of when failing to disclose certain information in proxy voting advice may be considered misleading.

The SEC may also propose new amendments to Exchange Act Rule 14a-8, which governs shareholder proposals. This rulemaking is expected to revisit the prior amendments adopted in September 2020,[15] which apply to any proposals submitted for annual or special meetings to be held on or after January 1, 2022.[16] The prior amendments raised the eligibility criteria for submission of shareholder proposals and resubmission thresholds, limited a person to one proposal per meeting, prohibited the aggregation of holdings to satisfy ownership thresholds, facilitated proponent engagement and updated other procedural requirements. In November 2021, the SEC staff reversed course on several aspects of its previously issued guidance for shareholder proposals.[17] Procedural amendments to shareholder proposal rules and updated SEC staff guidance regarding Rule 14a-8 no-action requests are discussed in further detail in the section titled "Consider Shareholder Proposal Trends and Developments."

ESG Disclosures. The SEC plans to adopt proposed rules to require enhanced ESG disclosures in several areas. First, the proposed rules would require companies to provide enhanced disclosures about the diversity of board members and nominees. These rules would likely supplement Nasdaq's new board diversity and disclosure rules, discussed in further detail in the section titled "Consider Recommendations To Increase Board and Workforce Diversity and Enhance Related Disclosures."

Second, the proposed rules would require enhanced disclosures regarding issuers' climate-related risks and opportunities. This topic was last formally addressed by the SEC through interpretive guidance in 2010, but has been highlighted in recent months by various commissioners and other stakeholders. In particular, Chair Gensler asked the SEC staff to provide updated recommendations with respect to governance, strategy and risk management related to climate risk, as well as specific metrics for items such as greenhouse gas emissions. The SEC staff is also considering

[14] See the Investor Advisory Committee's draft recommendation "Draft Recommendation of the Investor as Owner Subcommittee of the SEC Investor Advisory Committee Regarding Rule 10b5-1 Plans" (August 26, 2021).

[15] See our client alert "SEC Adopts Amendments to Shareholder Proposal Rules" (September 25, 2020).

[16] The prior amendments also included a transition period that allowed shareholders who met certain conditions to rely on the $2,000/one-year ownership threshold for proposals submitted for meetings held prior to 2023.

[17] See our client alert "SEC Staff Issues New Shareholder Proposal Guidance, Rescinding 2017-2019 Guidance" (November 5, 2021).

whether companies that have made forward-looking climate commitments, such as carbon-neutral goals, should be subject to additional disclosure requirements. In September 2021, the SEC's Division of Corporation Finance began issuing detailed comments regarding climate-related disclosures.[18] To date, the comments have been issued in stand-alone letters referencing the companies' most recent Form 10-K filings. The comment letters have addressed several topics, including asking companies to (i) disclose considerations the company has given to providing the same type of climate-related disclosure in SEC filings as corporate sustainability reports; (ii) identify and quantify any material past and/or future capital expenditures for climate-related initiatives; (iii) to the extent material, quantify or discuss the significant physical effects of climate change on the company's property or operations; (iv) to the extent material, disclose any weather-related impacts on the cost or availability of insurance; (v) identify or quantify any material compliance costs related to climate change, including compliance costs associated with relevant environmental regulations; (vi disclose any material litigation risks related to climate change and the potential impact to the company; (vii) disclose the material effects of transition risks related to climate change that may affect the company's business, financial condition and results of operations, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks or technological changes; and (viii) to the extent material, disclose the company's purchase or sale of carbon credits or offsets and any material effects on the company's business, financial condition and results of operations. Company responses should be informed by current Form 10-K disclosure requirements, and companies should be prepared to provide support for their materiality determinations. For further detail on SEC guidance on company climate change disclosures, see the section titled "Consider Impact of Climate Change and ESG in Company Disclosures."

Third, the proposed rules may expand the requirements adopted in 2020[19] to include specific topics, including workforce diversity. Chair Gensler noted in his June 23, 2021, remarks that a rulemaking proposal "could include a number of topics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics, including diversity, and health and safety." See the section titled "Prepare Human Capital Disclosures in Light of Recent Disclosure Trends and Developments" for further detail on workforce diversity disclosure trends.

Finally, the increasing number of high-profile cyber incidents and the SEC's heightened focus on cybersecurity signal that cybersecurity[20] and cybersecurity-related disclosures will continue to be a priority area for the SEC. Recent enforcement actions underscore the importance of (i) completeness and accuracy when describing cyber incidents to third parties, whether customers, clients or investors and (ii) disclosure controls and procedures that provide timely and accurate information to investors about material cyber events. The SEC staff has also warned that companies should not understate the nature and scope of cyber incidents or overstate the company's cyber protections. Issuers and other SEC-regulated entities should continuously monitor their cybersecurity safeguards, protocols, and disclosure controls and procedures, and provide complete, accurate and timely updates to disclosures, particularly in the event of a cybersecurity incident. The section titled "Revisit Internal Procedures Relating to Cybersecurity and Insider Trading" includes additional detail about suggested cybersecurity procedures for issuers.

[18] On September 22, 2021, the staff published a sample comment letter regarding climate change disclosures. The sample letter includes an illustrative, non-exhaustive list of comments that the Division of Corporation Finance may issue to companies about their climate-related disclosure or the absence of such disclosure.

[19] See the SEC's adopting release "Modernization of Regulation S-K Items 101, 103 and 105" (August 26, 2020).

[20] See our client alert "SEC Heightens Focus on Cybersecurity" (September 1, 2021).

Assess Impact of SEC Staff Comments

A recent study by Ernst & Young (EY)[21] observed that the SEC Division of Corporation Finance staff issued approximately 20% fewer comment letters on company filings during the 12-month period ended June 30, 2021, compared to the prior-year period, continuing the downward trend of recent years.

The EY survey revealed that the use of non-GAAP financial measures remained the most frequent area of comment. MD&A and segment reporting ranked second and third, respectively. Staff comments on revenue recognition dropped to fourth, after being in the top three in the last two years. Following the guidance and statements issued by the SEC in response to the COVID-19 pandemic, the EY study also noted that the SEC staff issued a number of comments on disclosures relating to the pandemic in periodic reports. Those comments generally focused on pandemic-related risk factors, known trends and uncertainties in MD&A, including expectations of the impact caused by the pandemic on a company's operating results and near- and long-term financial condition, and non-GAAP measures that were adjusted for the effects of the pandemic. Climate-related disclosures have recently been a new area of focus for staff comments.[22]

Below is a summary of the SEC staff's most noteworthy areas of focus.

Non-GAAP Financial Measures. The SEC staff continues to focus on non-GAAP financial measures and compliance with the staff's related interpretive guidance. Although the staff comments have remained focused on areas of historical interest for the staff, such as whether the most directly comparable GAAP financial measure is presented with equal or greater prominence relative to the non-GAAP measure, the staff has also focused on adjustments to non-GAAP measures that could be viewed as resulting in "individually tailored recognition and measurement methods."[23] These comments have objected to, among other things, excluding the impact of recently revised accounting standards, such as those related to revenue recognition and credit losses. As noted above, the staff also questioned how COVID-19 related non-GAAP adjustments were incremental to, and separable from, normal operations. The staff has also, at times, raised objections to the use of a particular non-GAAP measure because it believed the measure, notwithstanding compliance with the SEC's non-GAAP rules, is misleading and cannot be disclosed.

Although most of these comments target the use of non-GAAP measures in earnings releases and SEC filings, the SEC staff also reviews materials outside of SEC filings, including on company websites and in investor presentations. Therefore, companies should ensure that any public disclosures of non-GAAP financial measures comply with applicable SEC rules and staff guidance.

MD&A. The staff continues to raise questions about various aspects of MD&A, with the most common topic being the results of operation. It is not uncommon, for instance, for the staff to request that material changes in operations be quantified, including offsetting factors. The staff also focused on key performance indicators and operating metrics, including period-over-period comparisons and whether companies have disclosed key performance indicators used by management that would be material to investors. Key performance indicators can be financial or nonfinancial and vary based on a company's industry and business. In January 2020, the SEC issued interpretive guidance regarding disclosures required for key performance indicators and other metrics in their MD&A. While the guidance generally is consistent with prior

[21] See EY's SEC Reporting Update "Highlights of Trends in 2021 SEC Comment Letters" (September 23, 2021).

[22] See the section titled "Consider Impact of Climate Change and ESG in Company Disclosures" for further details.

[23] See SEC staff's Compliance & Disclosure Interpretations for "Non-GAAP Financial Measures" CDI 100.04 (April 4, 2018).

statements from the SEC staff, the issuance of commission-level guidance was noteworthy in that it demonstrated a greater interest in the use and disclosure of key performance indicators.

The SEC staff comments on MD&A have also focused on known trends or uncertainties, particularly related to COVID-19, that are reasonably expected to impact future results both in the near- and long-term. In its March 2020 guidance related to COVID-19 matters, the staff encouraged companies to think creatively about the kinds of forward-looking information they can provide to investors, as historical information may be relatively less significant given the economic and operational uncertainties resulting from the COVID-19 pandemic.

In addition to these topics, however, we expect staff comments will focus on the responses that companies make to the revised MD&A disclosure requirement.[24] As a result, particular attention should be paid to ensuring compliance with the new requirements.

[24] See the section titled "Consider Recent MD&A Amendments" for further details.

Consider Impact of Climate Change and ESG in Company Disclosures

As discussed in our April 30, 2021, client alert "SEC Primed To Act on ESG Disclosure," the SEC is increasingly focusing on company disclosures related to ESG matters such as climate change, corporate board diversity, human capital management, cybersecurity risk governance and political spending. Disclosures related to climate change in particular have come to the center of the SEC's attention, as indicated by recent statements and actions by the SEC and its staff. Beginning in September 2021, for example, as explained in our September 22, 2021, client alert "SEC Staff Issues Detailed Form 10-K Comments Regarding Climate-Related Disclosures," the staff in the SEC's Division of Corporation Finance has issued detailed, stand-alone comment letters regarding climate-related disclosures (or lack thereof) in companies' most recent Form 10-K filings. In addition, the SEC is expected to propose mandatory disclosure rules related to climate change by early 2022.

Even in the absence of specific disclosure rules on climate change and other ESG matters, any material impact of such matters should be disclosed under the SEC's existing rules. A brief overview of disclosure guidance by the SEC and its staff on climate change, which also would be informative for other ESG matters, is provided below.

SEC and Staff Disclosure Guidance on Climate Change

To date, the SEC and its staff have issued the following disclosure guidance related to climate change:

- On February 2, 2010, the SEC issued interpretive guidance, expressing its views regarding existing disclosure requirements as they apply to climate change matters.
- On February 24, 2021, then-Acting Chair Allison Herren Lee noted in a public statement that she directed the staff of the Division of Corporation Finance to review "the extent to which public companies address the topics identified in the 2010 guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks."
- On September 22, 2021, the staff of the Division of Corporation Finance published Sample Letter To Companies Regarding Climate Change Disclosures, which includes an illustrative, non-exhaustive list of comments that the staff may issue to companies about their climate-related disclosure or the absence of such disclosure in the companies' SEC filings.

Based on the guidance from the SEC and its staff to date, companies should consider the following topics, among other things, in their public reporting obligations and provide appropriate disclosures if material:

- Whether and to what extent climate-related disclosures provided outside of SEC filings, such as those included in a stand-alone ESG, sustainability, corporate responsibility or similar report, should be incorporated into SEC filings.
- Any past and/or future capital expenditures for climate-related initiatives.
- Physical effects of climate change on the company's property or operations.
- Weather-related impacts on the cost or availability of insurance.
- Compliance costs related to climate change, including compliance costs associated with existing and/or pending legislation and regulation related to climate change.
- Litigation risks related to climate change and the potential impact to the company.

- Effects of transition risks related to climate change that may affect the company's business, financial condition and results of operations (examples include risks related to policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks or technological changes).
- The company's purchase or sale of carbon credits or offsets and any related effects on the company's business, financial condition and results of operations.

In particular, companies should consider discussing material climate change risks and/or impacts in their disclosures, such as the MD&A, risk factors, descriptions of business or legal proceedings, as well as financial statements and accompanying notes. In addition, companies may want to revisit or enhance their proxy statement disclosures regarding board oversight of climate change and consider including additional proxy statement disclosure regarding climate change in light of the considerations outlined above.

Reassess Disclosure Controls and Procedures

Under the federal securities laws, all public company disclosures, whether included in SEC filings or not, must be accurate and complete in all material respects and not materially misleading.[25] For disclosures included in SEC filings in particular, SEC rules require public companies to maintain, and regularly evaluate the effectiveness of, disclosure controls and procedures (DCP) and chief executive officers (CEOs) and chief financial officers (CFOs) to quarterly certify the effectiveness of the company's DCP.[26] While these requirements are not new, given recent increases in ESG disclosures both within and outside of SEC filings, combined with the SEC's heightened focus on climate and other ESG issues, we believe companies should reassess their existing DCP and consider any necessary changes to help ensure the consistency, accuracy and reliability of their voluntary and required ESG disclosures, among other disclosures.

The SEC's Growing Focus on Climate and Other ESG Issues

Companies are increasingly providing disclosure about their current efforts and future commitments on ESG matters. One study found that, as of June 2021, 95% of S&P 500 companies had detailed ESG information publicly available, primarily outside of SEC filings and in a stand-alone ESG, sustainability, corporate responsibility or similar report.[27] To date, ESG disclosures are provided largely on a voluntary basis in response to requests for more information from investors, interest groups, employees and other stakeholders, as the scope of required ESG disclosures in SEC filings remains primarily principles- and materiality-based.

Recent statements and actions by the SEC and its staff, however, indicate that additional ESG disclosure requirements are likely in the near future, as discussed in our April 30, 2021, client alert "SEC Primed To Act on ESG Disclosure." As described in more detail above, in June 2021, Chair Gensler reaffirmed the SEC's focus on mandating additional ESG disclosures in his public remarks, noting that he had asked the SEC staff to provide recommendations on mandatory company disclosures on climate risk and on human capital. In addition, beginning in September 2021 and as discussed above, the SEC's Division of Corporation Finance has issued detailed, stand-alone comment letters regarding climate-related disclosures (or lack thereof) in companies' most recent Form 10-K filings.

Moreover, the SEC's Division of Enforcement is increasingly focusing on ESG-related disclosure matters, as signaled by the SEC's announcement of the creation of a Climate and ESG Task Force in March 2021. The SEC's announcement noted that the task force's initial focus will be to identify any material gaps or misstatements in companies' disclosure of climate risks under existing disclosure requirements and that the task force also will analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies. Although the SEC's enforcement actions related to ESG disclosures to date have largely focused on "greenwashing," or making potentially misleading claims about ESG-related characteristics, in asset management products, public companies are likely to face increased SEC scrutiny of their ESG disclosures.

[25] See Exchange Act Section 10(b) and Rule 10b-5. For example, the anti-fraud provisions of the federal securities laws apply to all publicly available company disclosures, including those not included in SEC filings such as information posted on corporate websites.

[26] SEC rules define DCP as controls and other procedures designed to ensure that information required to be disclosed in all SEC filings is (i) recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to the company's management as appropriate to allow timely decisions regarding required disclosures. See Exchange Act Rules 13a-15(e) and 15d-15(e).

[27] See Center for Audit Quality's "S&P 500 and ESG Reporting" (August 9, 2021).

Based on the initiatives already underway, the SEC is expected to take further actions through a combination of SEC interpretative guidance, SEC staff guidance, comment letters and/or enforcement activity focused on seeking greater transparency, accuracy and reliability for companies' voluntary and required ESG disclosures. In this regard, one area of focus in the SEC staff's comment letters has been the differential between ESG disclosures in SEC filings compared to more expansive ESG disclosures provided outside of SEC filings (such as a standalone ESG, sustainability, corporate responsibility or similar report). This focus is another indication that companies should reassess their DCP and consider whether any changes are needed to improve the consistency, accuracy and reliability of their ESG disclosures, whether provided voluntarily or in SEC filings.

Considerations for Implementing More Robust DCP

The SEC has not provided specific guidance on how best to establish DCP for ESG-related disclosures, and DCP can take many forms and varies by company depending on, among other things, the complexity and size of the company's business. As a result, each company should develop and tailor a process that is consistent with its business, management and supervisory practices. Some companies may find it appropriate to integrate voluntary ESG reporting into their existing DCP for SEC reporting, while others may develop DCP for voluntary ESG reporting as a separate structure, with separate processes, depending on the company's specific circumstances. Ideally, voluntary ESG disclosures should be vetted through a controls process as robust as DCP for disclosures included in SEC filings.[28]

[28] For further practical considerations, see our publication with the Society for Corporate Governance "Enhancing Disclosure Controls and Procedures Relating to Voluntary Environmental and Social Disclosures" (June 29, 2021).

Revisit Internal Procedures Relating To Cybersecurity and Insider Trading

Cybersecurity

As discussed in our September 1, 2021, client alert "SEC Heightens Focus on Cybersecurity," this year there were several cyber enforcement actions, which signal that cybersecurity continues to be a priority area for the SEC and should serve as a warning to companies to evaluate the adequacy of their policies and procedures.

Recent SEC Enforcement Matters

In August 2021, the SEC settled charges against a London-based foreign private issuer that publishes educational materials and provides other services to school districts in the United States for misleading investors about a cybersecurity breach and having inadequate disclosure controls and procedures.[29] In September 2018, the company was notified of a vulnerability in its servers and that a patch was available to address the issue. The company took no action until March 2019 after it learned that several million rows of data was stolen, including personally identifying information (PII) stored on a server. Only after the breach did the company implement the patch to address the concern. In July 2019, the company sent notice of the breach to impacted customer accounts but without providing full details of the breach. Shortly after sending the notice, the company filed a Form 6-K that discussed its data privacy risks but did not disclose the fact that one had occurred. Only after receiving a media inquiry in late July 2019 did the company issue a statement informing investors and the public about the breach. However, the public disclosures made misstatements about the nature of the breach and the data involved. The SEC described the company's statement as understating the nature and scope of the breach and overstating the company's data protections. The company paid a $1 million penalty.

In August 2021, the SEC also settled charges with eight SEC-registered broker-dealers and/or investment advisers affiliated with three firms for various cybersecurity failures leading to the exposure of PII of thousands of customers and clients.[30] The alleged failures ranged from (i) failure to protect accounts in a manner consistent with company policies, (ii) not adopting and implementing policies and procedures to review customer communications leading to misleading statements to such customers, (iii) failure to adopt and implement firmwide enhanced security measures until years after discovery of a breach, and (iv) failure to adopt written policies and procedures timely after discovering a breach and not implementing those additional security measures firmwide. The firms paid penalties in an aggregate amount of $750,000.

In another action in June 2021, the SEC settled charges with a real estate settlement services company relating to disclosure controls and procedures violations with respect to a cybersecurity vulnerability that exposed over 800 million title and escrow document images, including images containing sensitive PII.[31] A journalist brought the vulnerability to the attention of the company. In response, the company issued a public statement and disclosed the event in a Form 8-K. However, the senior executives responsible for producing the public response were not informed of certain details relevant to their assessment in developing such a response. For example, the SEC found that the company's disclosure controls and procedures failed to inform such senior executives that the company's information security personnel were previously aware of the vulnerability months earlier and that the company failed to address the issue in accordance with its policies. The company paid a $487,616 penalty.

[29] See the SEC's press release "SEC Charges Pearson plc for Misleading Investors About Cyber Breach" (August 16, 2021).

[30] See the SEC's press release "SEC Announces Three Actions Charging Deficient Cybersecurity Procedures" (August 30, 2021).

[31] See the SEC's press release "SEC Charges Issuer With Cybersecurity Disclosure Controls Failures" (June 15, 2021).

Recommended Actions

In light of these recent enforcement actions and continued SEC focus, companies should ensure that they have adequate policies and procedures in place to address their particular business needs, are following those policies and procedures, and address any known threats or breaches timely. In particular, it is very important that information about any threats or breaches is communicated to individuals responsible for making public disclosures so that all relevant information can be evaluated when communicating to impacted customers and the public.

Insider Trading

Misappropriation Theory of Insider Trading

The action the SEC filed in the matter outlined below was based on an extension of the misappropriation theory of insider trading beyond parties to a merger transaction.

SEC Enforcement Matter

In August 2021, the SEC brought insider trading charges against a former employee of a midsize oncology-focused biopharmaceutical company.[32] The employee had received nonpublic information that the company would be acquired and immediately purchased out-of-the-money options of Incyte Corporation — an unaffiliated but similarly situated company to the pharmaceutical company that could also be an acquisition target. When the acquisition of the pharmaceutical company was announced, the value of the employee's options in Incyte securities increased by about $100,000. The complaint alleges that the pharmaceutical company's insider trading policy forbade the employee from trading in securities of other public companies based on material nonpublic information concerning the pharmaceutical company. The complaint seeks, among other things, civil penalties and an officer and director bar for the insider.

While the employee has stated that the SEC is overstepping its bounds by bringing these charges, the complaint should be a warning that employees may have access to material nonpublic information that impacts trading in the securities of other public companies. While this action has yet to resolve itself, companies may be wise to review their insider trading policies with respect to such issue and alert their employees of these trading risks.

Rule 10b5-1 Trading Plans

In 2021, the SEC, including Chair Gensler, has identified several areas of concern relating to Rule 10b5-1 trading plans.[33] In particular, in September 2021, the SEC's Investor Advisory Committee made its recommendations to the SEC regarding regulatory and other changes with respect to such plans.[34] The committee's recommendations included: (i) a four-month cooling-off period between adopting a plan and the first trade made under the plan, (ii) not permitting overlapping plans, (iii) requiring all Forms 144 be filed electronically (Forms 144 are one of the few forms still permitted to be filed in paper format), (iv) requiring all companies with securities registered in the United States, including foreign private issuers, to be subject to Section 16 of the Securities Exchange Act of 1934, (v) requiring enhanced public disclosure of Rule 10b5-1 plans, including disclosure of such plans in proxy statements and Forms 8-K, and (vi) requiring all Forms 4 reporting a transaction under a Rule 10b5-1 plan to disclose that the transaction was made under such plan and the date of the adoption and/or modification of such plan, as applicable.

The Investor Advisory Committee believes that these recommendations would improve the disclosure requirements for Rule 10b5-1 plans by trying to balance requiring greater transparency to the investing public and improving the SEC's ability to investigate and enforce violations of the rule with permitting proper use of these plans by corporate insiders and issuers.

No rule changes have been enacted as of yet. However, companies should continue to monitor this development, particularly for its directors and officers.

[32] See the SEC's press release "SEC Charges Biopharmaceutical Company Employee with Insider Trading" (August 17, 2021).

[33] See our client alert "SEC Chair Gensler Previews Potential Changes for Rule 10b5-1 Plans" (June 10, 2021).

[34] See "Recommendation of the Investor Advisory Committee regarding Rule 10b5-1 Plans" (September 9, 2021).

Incorporate Lessons Learned From the 2021 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2022 Pay Ratio Disclosures

Companies should consider their recent annual say-on-pay votes and general disclosure best practices when designing their compensation programs and communicating about their compensation programs to shareholders. This year, companies should understand key say-on-pay trends as they addressed the COVID-19 pandemic, including overall 2021 say-on-pay results, factors driving say-on-pay failure (*i.e.*, those say-on-pay votes that achieved less than 50% shareholder approval) and equity plan proposal results, as well as guidance from the proxy advisory firms firms Institutional Shareholder Services (ISS) and Glass Lewis.

Overall Results of 2021 Say-on-Pay Votes

Below is a summary of the results of the 2021 say-on-pay votes from Semler Brossy's annual survey[35] and trends over the last 10 years since the SEC adopted its say-on-pay rules. Overall, despite the uncertain climate during much of 2020, say-on-pay results at Russell 3000 companies surveyed in 2021 were generally the same or slightly below those in 2020, at least due in part related to COVID-19 related responses.

- Approximately 97.2% and 97.7% of Russell 3000 companies, in 2021 and 2020, respectively, received at least majority support on their say-on-pay vote, with approximately 93% receiving above 70% support in both years. This demonstrates slightly reduced say-on-pay support in 2021 compared with 2020.
- ISS' support for say-on-pay proposals in 2021 through September 2021 continues to be among the highest observed over the last 10 years with 89% of companies surveyed receiving an ISS "For" recommendation — the same result as in 2020.
- Russell 3000 companies received an average vote result of 90.5% approval in 2021, which is slightly lower than the average vote result of 91% approval in 2020.
  - The average vote result exceeded 90% approval in 2021 across multiple industry sectors, including utilities, materials, industrials, consumer staples, energy, financials and consumer discretionary.
  - The communication services sector had the lowest level of average support of 84.6% compared with other industry sectors.
- Approximately 2.8% of say-on-pay votes for Russell 3000 companies failed in 2021 as of September 2021, which was slightly higher than the 2.3% failure rate for 2020 measured in September 2020.
- Approximately 11% of Russell 3000 companies and 12% of S&P 500 companies surveyed have failed to receive a majority support for say-on-pay at least once since 2011.
- 37% of S&P 500 companies and 30% of Russell 3000 companies surveyed have received less than 70% support at least once since 2011.

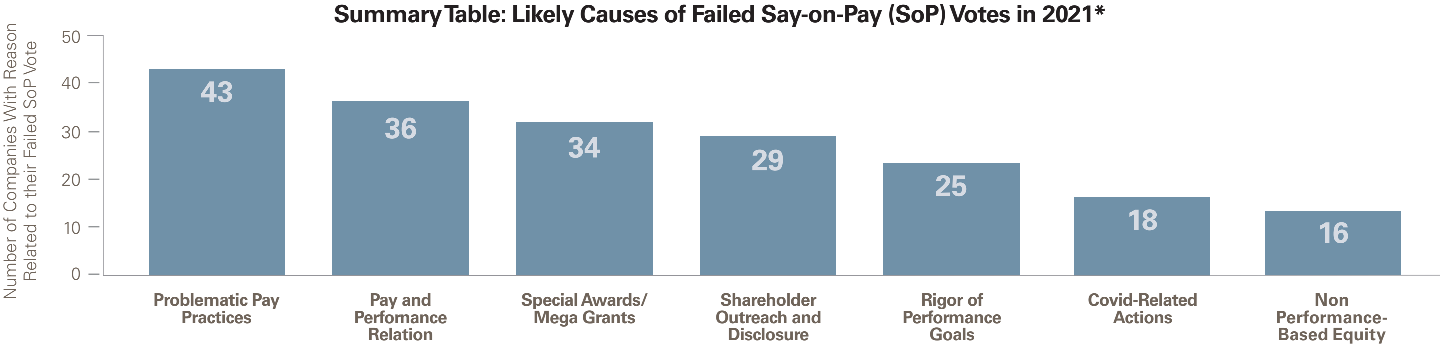
Factors Driving Say-on-Pay Failure

Overall, the most common causes of say-on-pay vote failure were problematic pay practices, pay and performance relation, special awards, shareholder outreach and disclosure, rigor of performance goals, COVID-related actions and nonperformance-based equity awards, as summarized in the chart below.[36]

[35] See Semler Brossy's report "2021 Say on Pay & Proxy Results" (September 30, 2021). See also Semler Brossy's report "2020 Say on Pay & Proxy Results" (September 24, 2020). Unless otherwise noted, Semler Brossy's report is the source of pay ratio, say-on-pay and equity plan proposal statistics in this annual client alert.

[36] See Semler Brossy's report "2021 Say on Pay & Proxy Results" (September 30, 2021).

Summary Table: Likely Causes of Failed Say-on-Pay (SoP) Votes in 2021*



*59 companies that failed on SoP were included in this survey. The same company may be counted towards multiple cases of failure.

Notably, special awards have increased from the fifth most frequently cited likely cause of say-on-pay vote failure in 2020 to the third in 2021, possibly due to increases in special awards made in connection with the COVID-19 pandemic, some of which were not reported as COVID-related actions. Otherwise, the likely causes of say-on-pay failure remained largely consistent between 2020 and 2021, with problematic pay practices and pay and performance relation (i.e., a disconnect between pay and performance) as the continuing frontrunners.

ISS Guidance

When evaluating pay practices, proxy advisory firms tend to focus on whether a company's practices are contrary to a performance-based pay philosophy. In December of each year, ISS publishes FAQ to help shareholders and companies understand changes to ISS compensation-related methodologies. In December 2020, ISS published its most recent general United States Compensation Policies FAQ[37], which included the following key updates:

- ISS' Multiple of Median (MOM) high concern threshold for S&P 500 companies is now three times the peer median rather than 3.33 times the peer median. This change was effective for meetings on or after February 1, 2021.
  - MOM is one of ISS' quantitative pay-for-performance screens that expresses the prior year's CEO pay as a multiple of the median CEO pay of its comparison group for the most recently available annual period.
- ISS indicated that it would assess COVID-related pay decisions based on its "U.S. Compensation Policies and the COVID-19 Pandemic" FAQ published on October 15, 2020.[38] However, ISS may release updated guidance about its approach to COVID-related compensation developments in the coming weeks, especially given that companies could better predict the impact of COVID-19 on their businesses and compensation programs in 2021 compared with 2020. Highlights from ISS' COVID-19 Pandemic FAQ are as follows:
  - The common theme underlying executive compensation and incentive plan design during the pandemic is to permit discretion to address novel issues that generally arise only during periods of extreme market volatility while expecting companies to offer robust disclosure about their compensation decisions.
  - The following should be disclosed to help investors evaluate COVID-19 pandemic-related changes to an annual incentive program:
    - specific pandemic-related challenges that arose and how those challenges rendered the original program design obsolete or the original performance targets impossible to achieve, as well as how changes to compensation programs are not reflective of poor management performance;
    - the rationale for making mid-year changes to bonus program design as opposed to the grant one-time discretionary awards (or vice versa) and how such decision relates to investor interests;
    - performance-based conditions that apply to discretionary awards; and

[37] See ISS' FAQ "United States Compensation Policies" (December 21, 2020).

[38] See ISS' FAQ "U.S. Compensation Policies and the COVID-19 Pandemic" (October 15, 2020).

  - how resulting payouts appropriately reflect individual and company annual performance and how they compare with payouts that would have been made under the original program design.
- ISS generally does not support changes to long-term incentive programs that are driven by the pandemic; provided that movement to relative or qualitative metrics may be viewed as reasonable under certain circumstances. ISS continues to frown upon shifts to predominantly time-vesting equity or short-term measurement periods.
- For additional information about ISS' "U.S. Compensation Policies and the COVID-19 Pandemic" FAQ, see our December 14, 2020, client alert "Matters to Consider for the 2021 Annual Meeting and Reporting Season."

ISS also made clear that companies will no longer receive credit for having stock ownership guidelines if such guidelines permit unearned performance awards or unexercised stock options (including vested unexercised options and "in the money" value of options) to count toward meeting stock ownership requirements. Unvested full value awards that require no exercise, such as time-based restricted stock and restricted stock units, may count toward stock ownership requirements without jeopardizing ISS credit.[39]

ISS' general United States Compensation Policies FAQ summarized which problematic practices are most likely to result in an adverse ISS vote recommendation. The problematic practices include the following and are expected to remain problematic in 2022:[40]

- repricing or replacing of underwater stock options or stock appreciation rights without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options);
- extraordinary perquisites or tax gross-ups, likely including gross-ups related to personal use of corporate aircraft, executive life insurance, secular trusts, restricted stock vesting, home-loss buyouts or any lifetime perquisites;
- new or extended executive agreements that provide for (i) termination or change in control severance payments exceeding three times the executive's base salary and bonus; (ii) change in control severance payments that do not require involuntary job loss or substantial diminution of duties; (iii) change in control payments with excise tax gross-ups, including modified gross-ups; (iv) multiyear guaranteed awards that are not at-risk due to rigorous performance conditions; (v) a "good reason" termination definition that presents windfall risks, such as definitions triggered by potential performance failures (*e.g.*, company bankruptcy or delisting); or (vi) a liberal change in control definition combined with any single-trigger change in control benefits; and
- any other egregious practice that presents a significant risk to investors.

Other issues contributing to low say-on-pay support include:

- inadequate disclosure around changes to performance metrics, such as disclosures that fail to explain changes and how they relate to performance;
- high-target incentives for companies that are underperforming relative to their peers;
- special bonuses and mega equity grants without sufficient rationale or risk-mitigating design features; and
- insufficient shareholder outreach and disclosure, including inadequate response to compensation-related concerns raised by shareholders.

ISS is expected to release a full set of updated compensation FAQ in December 2021, which will provide robust guidance for 2022.

Glass Lewis Guidance

Glass Lewis published its 2022 Policy Guidelines[41] for the United States, which included the following compensation updates that are expected to be in effect for the 2022 proxy season:

Environmental and Social Criteria and Executive Pay

Glass Lewis indicated that a company's particular circumstances should inform its decisions about whether and how to feature environmental and social (E&S) metrics in company compensation programs. Specifically, companies should consider factors such as their industry, size, risk profile, maturity, performance, financial condition and other relevant internal and external factors when determining whether and how to feature E&S metrics in their compensation programs.

Additionally, Glass Lewis expects companies to provide robust disclosure when they introduce E&S criteria into their executive incentive plans.

[39] See ISS' FAQ "United States Procedures & Policies (Non-Compensation)" (October 4, 2021).

[40] See ISS' FAQ "United States Compensation Policies" (December 21, 2020), FAQ Nos. 43 and 44.

[41] See Glass Lewis' "2022 Policy Guidelines" (November 15, 2021).

Such disclosure should include:

- how the E&S criteria align with the company's strategy;
- the rationale for selecting specific E&S metrics;
- a description of the target-setting process and corresponding payout opportunities;
- the basis on which E&S metrics will be assessed, particularly with respect to qualitative metrics; and
- targets for quantitative E&S metrics on an *ex ante* basis or why the board believes it is unable to make such a disclosure.

Glass Lewis made clear that some behaviors should be regarded as baseline requirements for executive performance and therefore should not generally need to be incentivized. For example, Glass Lewis indicates that it would support shareholder challenges to using metrics to reward executives for ethical behavior or compliance with policies and regulations.

Glass Lewis acknowledged that it generally supports company flexibility to determine whether to incorporate E&S metrics into their compensation programs, on both a general basis and with respect to short-term and long-term incentive compensation. In addition, Glass Lewis does not maintain a policy on the inclusion of such metrics.

Please see the section below titled "Consider Trends and Developments on Employee, Environmental, Social and Governance Metrics in Executive Compensation" for additional information on how environmental and social metrics are being featured in companies' compensation plans.

Short-Term and Long-Term Incentive Awards and Front-Loaded Awards

Glass Lewis clarified the following in its 2022 Policy Guidelines:

- It may consider adjustment to GAAP financial results and the basis for such adjustments when it analyzes both short-term incentive awards and long-term incentive awards for their effectiveness at tying executive pay with performance. Clear disclosure of reconciliations between non-GAAP or bespoke metrics and GAAP figures in audited financial statements is expected.
- Threshold, target and maximum performance goals under short-term incentive plans should be disclosed, in addition to the corresponding payout levels.
- Glass Lewis may consider the total potential dilutive effect on shareholders of a front-loaded equity award in addition to considering the quantum of the award on an annualized basis.

Recommended Next Steps

Overall, companies continue to attract attention from proxy advisory firms, institutional investors, the news media, activist shareholders and other stakeholders with respect to their executive compensation programs, especially in light of recent global talent shortages and workers' rights initiatives, the continued disproportionate impact of COVID-19 on low income workers and the Biden-Harris administration's economic recovery plans. This year's proxy season provides an opportunity for companies to clearly disclose the link between pay and performance and efforts to engage with shareholders about executive compensation. As always, these disclosures should explain the company's rationale for selecting particular performance measures for performance-based pay and the mix of short-term and long-term incentives. Companies also should carefully disclose the rationale for any increases in executive compensation, emphasizing their link to specific individual and company performance.

In the year following a say-on-pay vote, proxy firms conduct a thorough review of companies whose say-on-pay approval votes fall below a certain threshold: 70% for ISS and 80% for Glass Lewis. ISS' FAQ explain that this review involves investigating the breadth, frequency and disclosure of the compensation committee's stakeholder engagement efforts, disclosure of specific feedback received from investors who voted against the proposal, actions taken to address the low level of support, other recent compensation actions, whether the issues raised were recurring, the company's ownership structure and whether the proposal's support level was less than 50%, which should elicit the most robust stakeholder engagement efforts and disclosures.

Looking ahead to 2022, companies that received say-on-pay results below the ISS and Glass Lewis thresholds should consider enhancing disclosures of their shareholder engagement efforts in 2022 and the specific actions they took to address potential shareholder concerns. Companies that fail to conduct sufficient shareholder engagement efforts and to make these disclosures may receive negative voting recommendations from proxy advisory firms on say-on-pay proposals and compensation committee member reelection.

Recommended actions for such companies include:

- Assess results of the most recent say-on-pay vote. As part of this analysis, identify which shareholders were likely the dissenting shareholders and why.
- Engage key company stakeholders by soliciting and documenting their perspectives on the company's compensation practices. Analyze stakeholder feedback, determine recom-

mended next steps and discuss findings with relevant internal stakeholders, such as the compensation committee and the board of directors.

- Review ISS and Glass Lewis company-specific reports and guidance to determine the reason for their vote recommendations in 2021. Carefully consider how shareholders and proxy advisory firms will react to planned compensation decisions for the remainder of the current fiscal year and recalibrate as necessary. For example, consider compensation for new hires, leadership transitions and any special one-time grants or other arrangements.
- Determine and document which changes will be made to the company's compensation policies in response to shareholder feedback.
- Disclose specific shareholder engagement efforts and results in the 2022 proxy statement. Such disclosures should include information about the shareholders engaged, such as the number of them, their level of ownership in the company and how the company engaged them. They also should reflect actions taken in response to shareholder concerns, such as a company's decision to offer more robust disclosures or to adjust certain compensation practices.

Companies that have not changed their compensation plans or programs in response to major shareholder concerns should consider disclosing (i) a brief description of those concerns, (ii) a statement that the concerns were reviewed and considered, and (iii) an explanation of why changes were not made.

Say-on-Golden-Parachute Proposal Results

Say-on-golden-parachute votes historically have received lower support than annual say-on-pay votes, and this trend was even stronger in 2020. Average support for golden parachute proposals dropped from 79% in average support in 2019 to 76% in average support from January 1, 2020, through December 31, 2020.[42] ISS' negative vote recommendations were up in 2020 at 34%, from 28% in 2019. Companies should beware of including single-trigger benefits (*i.e.*, automatic vesting upon a change in control) in their parachute proposals, given that stakeholders cite single-trigger vesting as a primary source of concern, with tax gross-ups and performance awards vesting at maximum as significant secondary concerns. In addition, companies historically have also cited excessive cash payouts as a significant secondary concern.

[42] See Willis Towers Watson's "U.S. Executive Pay Votes—2020 Proxy Season Review" (March 2021).

Equity Plan Proposal Results

Equity plans continue to be widely approved, with 1% of equity plan proposals at Russell 3000 companies receiving less than a majority vote in 2021 through September 2021.[43] Average support for 2021 equity plan proposals as of September 2021 was 89%, which was lower than the 89.4% average support observed in September 2020.[44]

Most companies garner strong equity plan proposal support from shareholders, regardless of the say-on-pay results. As of September 2021, Russell 3000 companies with less than 70% say-on-pay approval that presented an equity plan proposal still received 85% support for the equity plan proposal.[45]

The threshold number of points to receive a favorable equity plan proposal recommendation from ISS is expected to remain at 57 points for the S&P 500 model, 55 points for the Russell 3000 model and 53 points for all other Equity Plan Scorecard models.[46]

ISS also provided guidance for companies that are intending to terminate an existing equity plan (including canceling any remaining shares reserved for awards thereunder) upon shareholder approval of a new equity plan. Under such circumstances, companies may make certain disclosures to dissuade ISS from including the shares available for issuance under the existing equity plan in ISS' Shareholder Value Transfer (SVT) analysis.[47] Such disclosures would typically be made in the company's annual report on Form 10-K filed prior to the proxy statement that requests shareholder approval of the new equity plan and include the following:

- the total number of shares remaining available for future awards under the existing equity plan, including any impact from fungible counting provisions, that will no longer be available upon approval of the new equity plan;
- the total number of full value awards and appreciation awards outstanding, disclosed separately and including the weighted average exercise price and remaining term of appreciation awards (and for performance-based awards, the number of shares with respect to the earned and unearned portions); and

[43] See Semler Brossy's report "2021 Say on Pay & Proxy Results" (September 30, 2021); see also Semler Brossy's report "2020 Say on Pay & Proxy Results" (September 24, 2020).

[44] See Semler Brossy's report "2021 Say on Pay & Proxy Results" (September 30, 2021).

[45] See *Id.*

[46] See ISS's FAQ "United States Equity Compensation Plans" (December 21, 2020); ISS' FAQ "U.S. Compensation Policies and the COVID-19 Pandemic" (October 15, 2020).

[47] See ISS's FAQ "United States Equity Compensation Plans" (December 21, 2020), FAQ No. 11.

- a commitment as of the date of the securities filing that no further shares will be granted as awards under the existing equity plan unless the new equity plan is not approved by shareholders.

Other Proxy Advisory Firm Takeaways

ISS' updated methodology for evaluating whether nonemployee director (NED) pay is excessive has taken effect and is expected to continue to apply in 2022. Under such policy, ISS may issue adverse vote recommendations for board members responsible for approving/setting NED pay. Such recommendations could occur where ISS determines there is a recurring pattern (two or more consecutive years) of excessive director pay without disclosure of a compelling rationale for those prior years or other mitigating factors.

Each year, companies should consider whether to make any updates to the compensation benchmarking peers included in ISS' database. ISS uses these company-selected peers when it determines the peer group it will use for evaluating a company's compensation programs. This year, ISS accepted these updates through December 3, 2021.[48]

Prepare for 2022 Pay Ratio Disclosures

The year 2022 marks the fifth year that SEC rules require companies to disclose their pay ratio, which compares the annual total compensation of the median company employee to the annual total compensation of the CEO.[49] This section helps companies prepare for the fifth year of mandatory pay ratio disclosures by considering the following:

- Can the same median employee be used this year, and, if not, what new considerations should be taken into account when identifying the median employee?
- What else do companies need to know for 2022?

Determining Whether To Use the Same Median Employee. Under Regulation S-K Item 402(u), companies only need to perform median employee calculations once every three years, unless they had a change in the employee population or compensation arrangements that could significantly affect the pay ratio. This requires companies to assess annually whether their workforce composition or compensation arrangements have materially changed.

When selecting a median employee for pay ratio disclosures about compensation in fiscal 2021, companies should consider the following:

- If the company has been using the same median employee for three years, they will need to perform median employee calculations for fiscal 2021.
- Other companies that were originally planning to feature the same median employee as last year should not do so if their employee populations or employee compensation arrangements significantly changed in the past year, including, without limitation, in response to the COVID-19 pandemic.

When selecting a median employee for pay ratio disclosures regarding fiscal 2021, companies should carefully consider how to incorporate furloughed employees, if applicable. For information on how to incorporate furloughed employees into pay ratio calculations, see our December 14, 2020, client alert "Matters to Consider for the 2021 Annual Meeting and Reporting Season."

Additionally, companies should consider how headcount changes may impact their ability to exclude certain non-U.S. employees from their pay ratio calculation under the commonly relied upon *de minimis* exception in Item 402(u)(4)(ii). Therefore, companies should evaluate whether non-U.S. employees in the aggregate and by jurisdiction newly constitute or no longer constitute more than 5% of the company's total employees.

- The *de minimis* exception generally allows a company to exclude non-U.S. employees when identifying their median employee, if excluded non-U.S. employees constitute 5% or less of their workforce.
  - If a company's non-U.S. employees account for 5% or less of their total employees, the company may either exclude all non-U.S. employees or include all non-U.S. employees.
  - Alternatively, if over 5% of a company's total employees are non-U.S. employees, the company may exclude up to 5% of its total employees who are non-U.S. employees; provided that the company exclude all non-U.S. employees in a particular jurisdiction if it excludes any employees in that jurisdiction, and employees excluded under Item 402(u)'s data privacy exception count toward this limit.
  - Non-U.S. jurisdictions with employees that exceed 5% of a company's total employees may not be excluded from the pay ratio calculation under the *de minimis* exception, although they may be permitted to be excluded under the data privacy exception.

Even if a company uses the same median employee in its proxy

[48] See ISS' article "Company Peer Group Feedback" (2021).

[49] Emerging growth companies, smaller reporting companies and foreign private issuers are exempt from the pay ratio disclosure requirement. Transition periods are also available for newly public companies.

statement filed in 2022 as in 2021, it must disclose that it is using the same median employee and briefly describe the basis for its reasonable belief that no change occurred that would significantly affect the pay ratio.

To determine whether a material change occurred, companies should generally continue to evaluate the following:

- How has workforce composition evolved over the past year?
  - Review hiring, retention and promotion rates.
  - Consider the applicability of exceptions under the pay ratio rules:
    - Determine whether to incorporate employees from recent acquisitions or business combinations into the consistently applied compensation measure (CACM). For example, for the fiscal year in which a business combination or acquisition becomes effective, a company may exclude individuals that become its employees as the result of the business combination or acquisition, as long as the company discloses the approximate number of employees it is omitting and identifies the acquired business that is being excluded.
    - Determine whether the *de minimis* exception applies within the context of the company's 2021 workforce composition. As described above, under this exception, non-U.S. employees may be disregarded if the excluded employees account for less than 5% of the company's total employees or if a country's data privacy laws make a company's reasonable efforts insufficient to comply with Item 402(u).
  - Analyze how the workforce used for the CACM is distributed across the pay scale and how the distribution has changed since last year.
- How have compensation policies changed in the past year compared to the workforce composition? For example, an across-the-board bonus that benefits all employees may not materially change the pay ratio, while new special commission pay limited to a company's sales team would do so.

Have the median employee's circumstances changed since last year? Consider changes to the employee's title and job responsibilities alongside any changes to the structure and amount of the employee's compensation, factoring in the company's broader workforce composition. Additionally, if the median employee was terminated, companies must identify a new median employee.

Although the SEC provides companies with substantial flexibility in calculating their pay ratios, to satisfy the SEC staff and engage with investors, employees and other stakeholders, companies should continue to diligently document and disclose their pay ratio methodology, analyses and rationale.

Consider Trends and Developments on Employee, Environmental, Social and Governance Metrics in Executive Compensation

Employee, environmental, social and governance (EESG) issues,[50] continue to be a high priority item for board and management teams as shareholders, customers and employees increasingly recognize EESG issues can materially impact company value. From an executive compensation perspective, EESG goals are most frequently reinforced through incentive compensation programs and clawback policies, with 57% of S&P 500 companies disclosing the use of some form of EESG metrics tied to incentive compensation.[51]

EESG Metrics and Incentive Compensation Programs

In recognition of growing expectations that companies confront EESG issues, companies are increasingly tying executive incentive compensation performance metrics to EESG factors, with the most common implementation of EESG metrics in annual incentive plans versus long-term incentive plans.

Quantitative research suggests that large public companies are spearheading implementation of EESG metrics in incentive plans with an emphasis on employee and social metrics:

- One study found that of the S&P 500 companies that incorporate EESG measures in their executive compensation programs, 28% use D&I metrics. Customer satisfaction was second at 27% and safety third at 24%.[52]
- The use of different EESG metrics is driven largely by business models and strategy, as expected, such as employee safety metrics in the energy and materials industry sectors. However, implementation of D&I metrics in incentives was prevalent across all industries, with implementation by 25% or more of the companies within seven of the 11 survey industries.[53]
- Another study found that 35% of surveyed companies (consisting of public, privately held and not-for-profit organizations) had already incorporated D&I metrics into their annual executive incentive plans and 9% had incorporated them into long-term incentive plans.[54]
- D&I prevalence in incentives is expected to continue to grow, and D&I metric prevalence increased by 19% year-over-year in S&P 500 proxy statements filed between January and March of 2021 versus 2020.[55]
- More companies are implementing EESG metrics in annual incentive plans (as opposed to long-term incentive programs), which may ultimately reach a larger population of employees. However, only a small fraction of the bonus is typically tied to achievement of EESG metrics, such as between 5% and 10% of the annual bonus.[56]
- One study found that of the S&P 500 companies that incorporate EESG metrics in incentive plans, it is most commonly incorporated as a scorecard (36%) or part of individual components (28%), with weighted metrics (20%) and modifiers (16%) being less common.[57]

[50] These topics are often referred to as ESG issues, but in recognition of the importance of employee-specific concerns regarding worker health and safety, pay equity and diversity in the workplace, this annual client alert adds an "E" for employee to such term. Otherwise, employee issues typically are grouped together with social issues, under the "S" in ESG.

[51] See Semler Brossy's "ESG + Incentives 2021 Report (Part 1)" (June 14, 2021) (according to public disclosures filed between March 2020 and March 2021).

[52] See *Id.*

[53] See Semler Brossy's "ESG + Incentives 2021 Report (Part 2)" (August 2, 2021).

[54] See Pearl Meyer's "Tracking and Reporting on Diversity, Equity, and Inclusion — Executive Summary" (October 2021).

[55] See Semler Brossy's "ESG + Incentives 2021 Report (Part 1)" (June 14, 2021) (according to public disclosures filed between March 2020 and March 2021).

[56] See Semler Brossy's "How To Translate ESG Imperatives into Executive Compensation" (September 22, 2021).

[57] See Semler Brossy's "ESG + Incentives 2021 Report (Part 3)" (September 13, 2021).

- Based on a 2021 study that included publicly traded, private for-profit and nonprofit organizations, 13% of all respondents and 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 EESG metric in 2022.[58]

The practice of linking executive compensation to achievement of EESG metrics continues to attract attention as companies grapple with implementing both qualitative and quantitative metrics. A few examples are as follows:

- McDonald's Corporation[59] announced earlier this year that it added new metrics to its executive short-term incentive plans, which focus on human capital management to reinforce the company's values and to hold executives accountable for advances in diversity, equity and inclusion. 15% of bonus achievement will be generally based on human capital metrics.
- Chipotle Mexican Grill, Inc.[60] is implementing EESG goals into its annual incentive program by tying executive compensation to EESG goals, which are categorized by Food & Animals, People and the Environment. For 2021, 10% of the overall annual incentive for executives will be based on achieving the new EESG factor.
- Medtronic PLC[61] announced that beginning in fiscal year 2022, its management incentive plan will include, in addition to key financial metrics, a qualitative scorecard to measure key non-financial metrics such as quality, strategic priorities, culture and inclusion, diversity, and equity. Performance against the non-financial metrics will be qualitatively evaluated by the compensation committee.
- The Proctor & Gamble, Co.[62] announced following an August 2021 meeting of its compensation and leadership development committee that an EESG factor will be applied to the 2021-22 annual incentive program for senior executives, which links pay to long-term equality and inclusion and environmental sustainability goals. The EESG factor will serve as a modifier of the company performance factor by consisting of a multiplier between 80% and 120% depending on such EESG performance.
- Seagate Technology Holdings PLC[63] also announced following a July 2021 meeting of its compensation committee that it intends to implement EESG modifiers with respect to PSUs, which will impact PSU achievement level based on the company's performance against both a social (gender diversity) goal and an environmental (greenhouse gas reduction) goal.

Although companies are increasingly considering how to feature EESG metrics in incentive plans, one study found that less than 3% of approximately 3,000 companies disclosed that fulfilling diversity goals was linked to a portion of their chief executives' pay, and few companies provided details on their diversity goals or the share of compensation that is contingent on them.[64] A recent survey of general counsel and senior legal officers in large and mid-sized companies sheds some light on the disparity, finding that although on average general counsel support EESG-related activities, there is significant concern for the legal and regulatory risk of disclosing these activities.[65] In fact, the survey found that companies currently disclose only a portion of the information they track relating to EESG initiatives.[66]

[58] See Pearl Meyer's "Looking Ahead to Executive Pay Practices in 2022 — Executive Summary" (November 2021).

[59] See McDonald's Corporation's "Definitive Proxy Statement on Schedule 14A" (April 8, 2021).

[60] See Chipotle Mexican Grill, Inc.'s "Definitive Proxy Statement on Schedule 14A" (April 5, 2021).

[61] See Medtronic PLC's "Definitive Proxy Statement on Schedule 14A" (August 27, 2021).

[62] See Proctor & Gamble Co.'s "Definitive Proxy Statement on Schedule 14A" (August 27, 2021).

[63] See Seagate Technology Holdings PLC's "Definitive Proxy Statement on Schedule 14A" (August 30, 2021).

[64] See *The New York Times*' article by Peter Eavis "Want More Diversity? Some Experts Say Reward C.E.O.s for It" (July 14, 2020).

[65] See Stanford Closer Look Series "The General Counsel View of ESG Risk" by Michael J. Callahan, David F. Larcker and Brian Tayan (September 14, 2021).

[66] See *Id.*

Evaluate Hart-Scott-Rodino Act Implications on Executive Compensation

Officers and directors who hold at least $92 million in voting securities in their companies should consider the need to make Hart-Scott-Rodino (HSR) filings whenever they increase their holdings through an acquisition of voting securities.[67] A company's annual preparation of its beneficial ownership table provides a regular opportunity to assess whether any of its officers or directors may be approaching an HSR filing threshold, in which case consulting HSR counsel is highly recommended. Importantly, HSR counsel also can advise when exemptions are available to obviate the need to file notifications.

An acquisition only is considered to occur when the officer or director obtains beneficial ownership of the shares. Therefore, acquisitions may include, without limitation:

- grants of fully vested shares as a component of compensation;
- the vesting or settlement of restricted stock units and performance-based restricted stock units;
- the exercise of stock options;
- open market purchases of shares; and
- the conversion of convertible non-voting securities into voting shares.

However, an officer or director would not be deemed to "acquire" shares underlying restricted stock units or performance-based restricted stock units that have not vested or shares underlying stock options that have not yet been exercised.

Generally, an "acquisition" can trigger a filing obligation.[68] For example, a filing requirement is not triggered solely by an increase in the value of an officer's holdings from $90 million to $95 million as a result of share price appreciation. However, if such officer subsequently wanted to exercise a stock option, an HSR obligation could be triggered.

The need for a filing is triggered whenever — after the acquisition of voting securities — an officer or director's holdings of voting securities in the company exceed an HSR filing threshold (the lowest of which is currently $92 million). Current holdings plus the proposed acquisition are considered to determine whether the threshold has been met.

Higher voting securities thresholds triggering additional HSR filings exist as well, with the next two currently fixed at $184 million and $919.9 million.[69]

If a filing is required, the individual would need to make an HSR filing and wait 30 days before completing the triggering acquisition. The filer has one year from clearance to cross the applicable acquisition threshold and the filer may make additional acquisitions for five years thereafter with no further HSR filings; provided that the filer does not cross the next HSR threshold above the level for which the notification was filed.

The Federal Trade Commission and Department of Justice have historically followed an informal "one free bite at the apple" enforcement practice when it comes to certain missed HSR filings, such that, if an officer or director inadvertently failed to make a required HSR filing, they should notify the agencies and submit a corrective filing detailing their previous

[67] The HSR Act establishes a set of notification thresholds that are adjusted annually based on changes to the gross national product. The initial threshold for 2021 is $92 million and the new thresholds will be established in the first quarter of 2022.

[68] Note that an HSR reporting obligation also can be triggered by an increase in one's voting power (i.e., holding or acquiring voting securities that provide more than one vote per share). HSR counsel can assist with analyzing the impact on the filing requirements.

[69] See the Federal Trade Commission's "HSR Threshold Adjustments and Reportability for 2021" (February 17, 2021).

acquisitions and how they plan to meet filing obligations in the future. This one "free bite" may cleanse all prior missed filings that occurred before the corrective filing.

However, the Federal Trade Commission and Department of Justice have been known to pursue enforcement actions and may impose material civil penalties of up to $43,792 per day if an executive officer or director subsequently fails to make a required HSR filing, even if such failure was truly inadvertent.[70] Therefore, officers and directors who have made a corrective filing should be especially vigilant and consult HSR regularly before a potential subsequent "acquisition" event is expected to occur.

[70] See the Federal Trade Commission's "FTC Fines Capital One CEO Richard Fairbank for Repeatedly Violating Antitrust Laws" (September 2, 2021).

Note Status of Pending SEC Rulemaking Relating to Clawback Policies Under Dodd-Frank

Executives are frequently paid based on how well their companies are performing. In some cases, however, the evaluation of company performance is based on inaccurate financial reporting, including objective financial targets such as revenue and overall business profits. If an error is discovered, executives may have been paid for meeting certain performance-based milestones that were not actually achieved. The pending SEC rulemaking relating to clawback policies under the Dodd-Frank Act will determine whether executives must pay back any portion of such erroneously awarded incentive-based compensation.

As explained below, members of the public are invited to comment on the proposed rule, and companies may consider taking various actions in connection with the proposed rule.

Brief History of the Clawback Rule Proposal and Comments

Congress first mandated clawbacks under Section 304 of the Sarbanes-Oxley Act of 2002 (SOX 304), which requires public companies to clawback incentive-based compensation paid to their CEOs and CFOs in the event of an accounting restatement due to material noncompliance with financial reporting requirements.[71] SOX 304 applies only to incentive-based compensation received during the 12-month period following the filing of any financial statement that the company is required to restate as a result of misconduct.

Following the financial crisis of 2007-08, Congress broadened its clawback requirements pursuant to the Dodd-Frank Act. Under Section 954 of the Dodd-Frank Act, Congress requires the SEC to adopt a rule that directs national securities exchanges to prohibit the listing of any security of a company that fails to develop and implement a clawback policy.[72] In particular, the clawback policy must provide that, in the event the company is required to prepare an accounting restatement due to material noncompliance with financial reporting requirements, the company must recover from any current or former executive officer up to three years of any incentive-based compensation that was based on the erroneous data, regardless of whether any misconduct occurred.

This clawback rule was previously proposed by the SEC in 2015.[73] In October 2021, the SEC re-opened comment on the clawback rule so that members of the public can submit further comments to the proposed rule, including the potential accounting and economic effects of the rule in light of any new developments since 2015.[74] In connection with the most recent proposal, Chair Gensler released a statement that he believes the SEC has an opportunity to strengthen the transparency and quality of corporate financial statements, as well as the accountability of corporate executives to their investors under the proposed rule.[75]

Clawback Requirements

The clawback rule, as proposed, would require national securities exchanges to establish listing standards that require public companies to adopt and comply with a clawback policy. Noncompliant companies would be subject to delisting. While this rule would affect nearly every listed

[71] See 15 U.S.C. § 7243.

[72] See 15 U.S.C. § 78j-4(b).

[73] See the SEC's proposing release "Listing Standards for Recovery of Erroneously Awarded Compensation" (July 1, 2015).

[74] See the SEC's reopening release "Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation" (October 14, 2021).

[75] See the SEC's press release "SEC Reopens Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation" (October 14, 2021).

company, it is important to note that, since 2015, many companies have already adopted clawback policies for governance reasons and to garner shareholder support. In particular, clawback policies are viewed favorably by ISS, and more than 90% of the companies in the S&P 500 index already have a clawback policy in place.[76] Therefore, the main focus of public comments to the proposed rule concern the substance of the SEC's clawback policy rather than the proposed adoption or disclosure of a policy in general.

Under the proposed rule, the clawback policy would apply specifically to incentive-based compensation that is based on financial information. This means that if there is an accounting restatement due to material noncompliance with applicable financial reporting requirements, the company would have to recover, from any current or former executive officer, the excess between what they actually received and the amounts that would have been paid under the numbers in the restated financial statements. This recovery would apply to the three fiscal years preceding the date of the restatement. In other words, the clawback policy would apply to anyone who was a Section 16 officer of the company at any time during the three-year lookback period. The clawback policy would also apply on a "no fault" basis, without regard to whether any misconduct occurred, or whether an executive officer had any responsibility related to the financial statements.

Moreover, companies must recover compensation in compliance with their clawback policy, except in the following two circumstances: (i) where it would be impracticable to do so, such as where the direct expense of enforcing recovery would exceed the amount to be recovered, and (ii) where recovery would violate home country law with respect to foreign private issuers. One common criticism to these exceptions is that they are too narrow and fail to address the application of state laws. For example, in California, labor laws prohibit the recovery of wages after they have been paid.

Finally, companies would be prohibited from indemnifying executives against the loss of any recovered compensation pursuant to the clawback policy.

In addition to adopting a clawback policy, each listed company would also be required to file the clawback policy as an exhibit to its annual report and disclose the company's actions to enforce the clawback policy, including information regarding recoveries, such as the amounts and the names of the executives involved.

Summary of Prior Comments and Proposal Timeline

Key concerns of various commenters in 2015 included the following:

- The proposed rule applies not only to incentive-based pay tied to financial reporting measures, but also to compensation based on stock price or total shareholder return (TSR). For awards that are tied to stock price or TSR, it is unclear how to calculate the amount that would be required to be clawed back.
- Almost all issuers are subject to the proposed rule, including issuers that are otherwise excluded from other disclosure requirements, such as emerging growth companies and smaller reporting companies.
- Boards of directors are afforded too little discretion and would not be permitted to allow an executive to repay in installments under a payment plan.
- The three-year lookback period under the proposed rule could impact executives who have already left the company and/or served as executive officers for a very short period of time.
- Recovery of incentive-based compensation is on a pre-tax and not an after-tax basis, meaning the calculation does not take into account that executives may have already paid taxes on the earned amounts.
- The obligation to recover compensation is not triggered by a clear, objectively determinable date, but rather the date the company's board of directors concludes, or reasonably should have concluded, that the company's previously issued financial statements contain a material error, or a series of immaterial errors that in the aggregate could necessitate a restatement.

The SEC will review all comments submitted on the 2015 proposal as well as the 2021 proposal before revising and reproposing the clawback rule in the spring of 2022. Afterward, it is possible that the rule will become effective in 2022 and apply to any fiscal period that ends on or after the effective date of the new rule.

Compensation Committee Action Items

Given the concerns raised by commenters and the SEC's renewed interest in finalizing the clawback rule, compensation committees may consider taking the following three actions for 2022:

- review the company's existing clawback policies and procedures for compliance with the proposed clawback rule;
- ensure processes are in place for careful recordkeeping to comply with the three-year clawback period applicable to current and former executives; and
- review the compensation committee's charter to confirm the committee is able to enforce any required clawback policy.

[76] See Equilar's "Corporate Governance Outlook 2018" (December 2017).

Consider Recommendations To Increase Board Diversity and Enhance Related Disclosures

Board diversity has remained at the forefront of the minds of investors over the past year. In 2021, numerous institutional investors vocalized their demands for greater board diversity, lawmakers and securities exchanges put forth new board diversity rules, and shareholders sought to hold companies accountable for allegedly failing to follow through with their previously disclosed board diversity commitments. Board diversity is expected to continue to be a preeminent focus for the upcoming 2022 proxy season, so companies should consider proactively taking steps to begin complying with applicable board diversity disclosure rules and investor requests to increase diversity in the boardroom.

Sustained Focus on Board Racial and Ethnic Diversity

Companies should be mindful of investor expectations related to board diversity, including investor voting policies and proxy advisory firm guidelines. For example, in January 2021, BlackRock released Chairman and CEO Larry Fink's annual letter to CEOs, asking companies to provide "disclosures on talent strategy fully reflect [their] long-term plans to improve diversity, equity, and inclusion." BlackRock expects companies to provide board diversity disclosures (including race and ethnicity data) to enable investors to make informed diversity assessments, "with an eye toward more voting action against boards not exhibiting diversity in 2022."[77] In addition, BlackRock will focus more on average director tenure, in seeking "a balance between the knowledge and experience of seasoned directors and the fresh perspective of newer directors."

Also in January 2021, State Street Global Advisors (SSGA) CEO Cyrus Taraporevala announced in his annual letter to board chairs primary stewardship priorities for 2021, including a focus on a lack of racial and ethnic diversity at both the company board and workforce levels. The letter recognizes a positive correlation between boards with racial and ethnic diversity and, among other things, long-term financial performance. SSGA concurrently published updated guidance on enhancing racial and ethnic diversity disclosures, introducing new voting policies relating to diversity disclosures. Notably, SSGA will vote against the chair of the nominating and governance committee at S&P 500 and FTSE 100 companies that do not (i) disclose the racial and ethnic composition of their boards (beginning in 2021), and (ii) have at least one director from an underrepresented community on the board (beginning in 2022).

Similarly, in December 2020, Vanguard updated its Investment Stewardship Insights and continued to call for companies to disclose the diversity makeup of their boards on dimensions, such as gender, age, race, ethnicity and national origin, at least on an aggregate basis. While Vanguard does not advocate for "one-size-fits all mandates," in 2021, Vanguard funds began voting against directors, including nominating committee chairs, at companies where progress on board diversity fell behind market norms and expectations.

In July 2021, Fidelity International updated its sustainable investing voting principles and guidelines with expectations for companies to, among other things, improve board diversity. Companies that fall short of market or sector best practice with respect to board gender, race and ethnic diversity are expected to adopt objectives for improvement and demonstrate progress over time. A board that does not adequately address this issue may receive votes against the reelection of members of the board, which may include the chair of the board or its nomination committee. In particular, Fidelity generally will vote against reelection of directors at companies that do not have at least 30% women on the board of directors in certain markets, including the U.S., U.K. and EU.

[77] See BlackRock's "Our 2021 Stewardship Expectations" (December 2020).

As discussed in the section titled "Assess Impact of Proxy Advisory Voting Guidelines by ISS and Glass Lewis," for annual meetings on or after February 1, 2022, ISS will recommend voting against the nominating committee chair of any Russell 3000 or S&P 500 company that has no racial or ethnically diverse board members, and, beginning in 2022, Glass Lewis will generally recommend voting against the chair of the nominating committee of a board with fewer than two gender diverse directors, or the entire nominating committee of a board with no gender diverse directors for Russell 3000 index companies. Similarly, both ISS and Glass Lewis will assess board diversity disclosures provided by S&P 500 companies in their 2022 proxy statements, highlighting companies whose boards lack racial and ethnic diversity or fail to provide adequate diversity disclosures.[78]

Diversity Disclosure Trends

While the SEC's Spring 2021 rulemaking agenda includes disclosure related to corporate board diversity and workforce diversity, the SEC has not yet issued final rules requiring such disclosures. Nonetheless, in 2021, many companies voluntarily expanded their public disclosures related to board diversity. Companies are increasingly using their proxy statements to provide investors clarity on how diversity, equity and inclusion matters are addressed. In 2021, approximately 59% of S&P 500 companies disclosed the racial composition of their boards, more than double compared to the prior year.[79] Similarly, approximately 27% of Russell 3000 companies provided such disclosure in 2021, more than triple compared to the prior year. This trend is expected to continue in the upcoming proxy season, in light of the sustained investor focus on board diversity, as well as the new Nasdaq rules discussed below.

For additional considerations regarding workforce diversity disclosures, see the section titled "Prepare Human Capital Disclosures in Light of Recent Disclosure Trends and Developments."

New Nasdaq Rules

As discussed in our August 10, 2021, client alert "SEC Approves Nasdaq Board Diversity Listing Standards," starting in 2022, Nasdaq-listed companies will be subject to two new requirements: (i) annual public disclosure of board-level diversity statistics using a standardized matrix template under Nasdaq Rule 5606 and (ii) complying with, or disclosing why they do not have, board diversity objectives under Nasdaq Rule 5605(f).

Board Diversity Matrix. Nasdaq Rule 5606 will require companies to disclose, following a standardized matrix format, the number of directors who self-identify according to specified categories, including gender, race/ethnicity and LGBTQ+ status. Companies should consider soliciting this information from directors and nominees, as well as individual consent to use such information in company disclosures, which can be done through the annual D&O questionnaire process.[80] For the first year of compliance in 2022, Nasdaq-listed companies are required to disclose the board diversity matrix by the later of (i) August 8, 2022, or (ii) the date the company files its proxy or information statement for its 2022 annual meeting of shareholders (or, if the company does not file a proxy or information statement, in its annual report on Form 10-K or 20-F). The matrix disclosure can be included in one of the foregoing filings, as applicable, but not required if such matrix is posted on the company's website.[81] Accordingly, companies with fiscal year ending December 31, 2021, can omit the matrix disclosure in its annual proxy or information statement (or its annual report on Form 10-K or 20-F) filed before August 8, 2022, then post the matrix disclosure on the company website by the August 8, 2022 deadline.[82]

Comply or Explain. Nasdaq Rule 5605(f) requires companies to meet specified board diversity objectives, or otherwise explain the company's reasons for not meeting such objectives. Subject to limited exemptions and transition periods, companies will be required to have, or explain why they do not have, one diverse director by August 7, 2023, and two diverse directors by August 6, 2025 or 2026, depending on listing tier.[83] Companies may reference Nasdaq's related FAQs to understand and assess compliance with the new rules.

Legal Challenges to New Rules. Currently, there is at least one pending lawsuit challenging the SEC's authority to approve the rule. Shortly after the SEC issued a final order approving the Nasdaq proposal, the Alliance for Fair Board Recruitment (AFFBR), filed a petition for review in the Fifth Circuit Court of Appeals, arguing that Nasdaq Rule 5605(f) is unconstitutional because it will compel companies to unlawfully discriminate on the basis of gender, race and sexual orientation when selecting directors. The AFFBR claims that the SEC's approval of this rule exceeds the agency's authority under federal securities law and violates constitutional guarantees against compelled speech and discrimination based on sex and race. While it remains unclear how the case will unfold, the arguments will likely focus on the SEC's authority under the Exchange Act and related constitutional concerns.

[78] In addition, for the 2022 proxy season, both ISS and Glass Lewis recommended voting against nominating committee chairs of all-male boards, and Glass Lewis recommended voting against nominating committee chairs where boards have fewer than two female directors (unless a company's board of directors is comprised of six or fewer members, in which case the current voting policy of requiring at least one female director continued).

[79] See The Conference Board's "Corporate Board Practices in the Russell 3000, S&P 500 and S&P MidCap 400: 2021 Edition" (October 2021).

[80] For additional guidance on gathering information to prepare the matrix, including sample questions, refer to Nasdaq's FAQ 1803 (August 24, 2021).

[81] For additional guidance on website posting of the matrix, see Nasdaq's FAQ 1755 (August 6, 2021).

[82] Nasdaq clarified deadlines for initial compliance in its FAQ 1796 (August 18, 2021).

[83] Nasdaq clarified deadlines for initial compliance in its FAQ 1748 (August 13, 2021).

State Diversity Laws

Companies may be subject to additional state requirements and should confirm their applicability. Below is a summary of several notable state laws.

California. Any public company whose principal executive office is located in California, as identified in its Form 10-K, is required to have a minimum number of diverse directors.[84] Most recently, a law enacted in September 2020 requires such companies to have at least one director from an underrepresented community[85] by the end of 2021 and two or three such directors by the end of 2022, depending on board size.[86] In addition, a related California law enacted in 2018 mandates that boards with five members have at least two female members, and those with six or more members have at least three female members by December 2021. Both laws require companies to report compliance to the California secretary of state, who is authorized to impose fines of $100,000 for a first-time violation and $300,000 for each subsequent violation. The 2018 gender diversity law has already been challenged in court in multiple lawsuits. One suit involves a shareholder alleging that the law requires shareholders who elect directors to discriminate on the basis of sex, in violation of the 14th Amendment. The Ninth Circuit Court of Appeals reversed a district court's dismissal of the case and held that contrary to the lower court's decision, the shareholder has standing to sue, thus paving the way for the suit to proceed in the lower courts. In November, the National Center for Public Policy Research filed a separate complaint in federal district court alleging that both California laws are unconstitutional under the equal protection provisions of the 14th Amendment. Both suits currently remain pending.

Other State Mandates. Other states have passed similar laws. For example, New York law requires companies that are "authorized to do business in [the] state" to disclose the number of women on their boards. Illinois law requires any public company whose principal executive office is located in Illinois to annually report to the secretary of state the number of board members who identify as women or racial or ethnically diverse and other information relating to board and management diversity. Beginning in 2022, Washington law will require public companies incorporated in Washington state to comply with board gender thresholds or otherwise provide public disclosure of the company's approach to developing and maintaining diversity on its board.

Proposed Legislation in Other States. A number of other states, including Hawaii, Massachusetts, Michigan and New Jersey, are considering mandatory board gender diversity legislation applicable to public companies with principal executive offices in the relevant state. Such legislation would require varying minimum numbers of female directors, deadlines for implementation and associated penalties for non-compliance. In 2019, Pennsylvania proposed a resolution encouraging, but not requiring, diverse gender representation on boards and broadly called for more corporate leadership opportunities for women.

Shareholder Lawsuits

Throughout 2021 and in light of the global racial equity movement that has continued to gain momentum among investors and other stakeholders, many companies represented to the public, either in their annual proxy statements or through other means, that they were committed to actively seeking women and minority candidates for management and/or board positions. As discussed in our April 13, 2021, client alert "Shareholder Suits Demand More Progress on Diversity," at least 12 public companies have been sued by their shareholders, who accused directors and officers of failing to diversify their boards and C-suites and of failing to comply with anti-discrimination laws. The lawsuits also typically alleged that the companies in question falsely touted their commitment to diversity.

The crux of the allegations presented in these lawsuits is that, despite company statements indicating commitments to diversity, the board is not diverse and has taken no real steps or has taken inadequate steps toward increasing board diversity. The lawsuits aim to force specific changes at the companies themselves and, in some cases, require them to contribute to or participate in diversity and inclusion efforts outside the corporation.

Notably, the lawsuits warrant particular attention for a few reasons: companies with women and/or minorities on board and senior executive teams have been sued, the remedies sought in these cases (*e.g.*, replacement of specific board members) are rarely, if ever, sought in typical derivative suits, and derivative suits brought by shareholders frequently name executive officers and directors as individual defendants based on allegations that they violated their fiduciary duties to the company. While a number of these derivative suits have since been dismissed, it remains unclear whether similar suits will withstand company motions to dismiss and the overall impact of such litigation on corporate board diversity reporting and accountability efforts.

[84] Nasdaq explained how its board diversity requirements align with the California law and highlighted key differences in its FAQ 1777 (August 6, 2021) and its "Summary of Key Differences between Nasdaq's Board Diversity Rule and California's Diversity Law" (August 6, 2021).

[85] See the California secretary of state's "Underrepresented Communities on Boards" (2021). A director from an underrepresented community is an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian or Alaska Native, or who self-identifies as gay, lesbian, bisexual or transgender.

[86] Companies with (i) five to eight directors must have at least two directors from underrepresented communities, and (ii) nine or more directors must have at least three directors from underrepresented communities.

Assess Impact of Proxy Advisory Voting Guidelines by ISS and Glass Lewis

Proxy advisory firm Glass Lewis[87] has updated its voting guidelines for the 2022 annual meeting season, and ISS has proposed updates to its voting guidelines.[88] Companies should assess the potential impact of these updates when considering changes to their corporate governance practices, shareholder engagement and proxy statement disclosures. Companies should also keep in mind that ISS often includes policy updates in its final voting policy that did not appear in the proposed updates.

Board Diversity.[89] Starting in 2022, ISS will recommend voting against or withhold from the chairs of nominating committees — or other directors on a case-by-case basis — of companies in the Russell 3000 or S&P 1500 with no apparent racial or ethnically diverse board members and for which no mitigating factors are identified. ISS provides an exception to this voting policy if a board included a racial and/or ethnic minority member at the preceding annual meeting and if the company makes a firm commitment to appoint at least one racially and/or ethnically diverse director within one year. In determining its specific recommendation, ISS will consider aggregate diversity statistics provided by company boards if the statistics are specific to racial and/or ethnic diversity.

In 2022, Glass Lewis may recommend voting against the chair of a company's nominating committee if the company has "particularly poor disclosure" concerning director diversity and skills. In addition, starting in 2023, Glass Lewis will generally recommend voting against the chairs of nominating committees at companies that do not provide any disclosure regarding individual or aggregate director racial/ethnic diversity data. For annual meetings held after August 8, 2022, Glass Lewis also will recommend voting against nominating committee chairs of Nasdaq-listed companies that do not comply with Nasdaq's board diversity disclosure requirements.

Gender Diversity. ISS' guidelines provide that it will recommend voting against the chair of the nominating committee (or other directors as appropriate), with limited exceptions, of an all-male board of directors, unless the company included proxy statement disclosure of a "firm commitment" to appoint at least one woman to the company's board within a year. The requirement currently only applies to Russell 3000 and S&P 1500 companies; however, ISS has proposed that beginning on February 1, 2023, the policy will apply to companies outside of the Russell 3000 and S&P 1500 indices.

In 2022, Glass Lewis generally will recommend voting against the nominating committee chair of a board with fewer than two gender-diverse directors.[90] Beginning in 2023, however, Glass Lewis will transition to a percentage-based approach and will generally recommend voting against nominating committee chairs of boards that are not at least 30 percent gender diverse. Depending on the circumstances, Glass Lewis may extend its voting recommendation to additional members of the nominating committee. In determining its recommendation, Glass Lewis will consider company disclosure of its diversity considerations and may refrain from recommending that shareholders vote against directors if a board has provided a sufficient rationale or plans to address the lack of diversity on its board. Glass Lewis also revised references in its guidelines from "female directors" to "gender diverse directors."

[87] See Glass Lewis' "2022 Policy Guidelines — United States" (November 15, 2021) and Glass Lewis' "2022 Policy Guidelines — ESG Initiatives" (November 24, 2021).

[88] See ISS' "Proposed ISS Benchmark Policy Changes for 2022" (November 4, 2021).

[89] For additional information regarding board diversity disclosure, see the section titled "Consider Recommendations To Increase Board Diversity and Enhance Related Disclosures."

[90] For companies outside of the Russell 3000 index or with boards that have six or fewer members, Glass Lewis' existing voting policy requiring a minimum of one gender-diverse director will remain in place.

ESG Oversight.[91] Beginning with shareholder meetings held after January 1, 2022, Glass Lewis will generally recommend voting against the governance chair of a company in the S&P 500 that fails to provide explicit disclosure concerning the board's role in overseeing ESG matters. Such oversight can be conducted by the full board, a separate committee, existing committees or individual directors. In addition, Glass Lewis will consider the following factors when determining its recommendations on management-sponsored environmental and social proposals:

- the request of the resolution and whether it would materially impact shareholders;
- whether there is a competing or corresponding shareholder proposal on the topic;
- the company's general responsiveness to shareholders and to emerging environmental and social issues;
- whether the proposal is binding or advisory; and
- management's recommendation on how shareholders should vote on the proposal.

Climate Change. ISS' proposed guidelines include a policy to vote, beginning in 2022, against incumbent directors, committees or boards at companies that are significant greenhouse gas emitters if ISS determines that the companies are not taking certain "minimum steps" to understand, assess and mitigate climate-change related risks to the company and the economy. The proposed policy includes certain minimum disclosure and emissions reduction targets and describes how companies can meet the minimum requirements. In addition, ISS would recommend, on a case-by-case basis, management and shareholder proposals regarding a company's climate transition plan. The proposed guidelines state that, depending upon the source of the proposal, ISS will take into account the completeness and rigor of the plan, as well as other matters, including the completeness of the company's climate disclosures and whether the company has sought and received third-party approval that its targets are science-based.

Glass Lewis' updated ESG policies state that it will generally oppose shareholder proposals requesting that companies adopt a say-on-climate vote, although Glass Lewis will evaluate say-on-climate votes regarding climate transition plans on a case-by-case basis, taking into account matters such as the company's engagement with shareholders on the issue and the company's operations and risk profile.

[91] For related ESG updates, see the section titled "Consider Impact of Climate Change and ESG in Company Disclosures."

SPACs. Following a company's business combination with a special purpose acquisition company (SPAC), Glass Lewis will generally recommend voting against all members of the board who served at the time of the combination if, preceding the combination, the company adopted overly restrictive governing documents, including certain multi-class share structures or an anti-takeover provision. Glass Lewis will make such a recommendation if the board:

- did not hold a shareholder vote on these matters at the meeting during which shareholders approved the business combination;
- did not commit to holding a shareholder vote on the provisions at the company's first shareholder meeting following the business combination; or
- did not provide for a reasonable sunset of the provisions.

In addition, Glass Lewis has adopted a new policy that directors whose only executive role is at a SPAC will be subject to the same overboarding requirements as outside directors rather than executive directors. Therefore, Glass Lewis will generally recommend that shareholders vote against a director whose sole executive role is at a SPAC if he or she serves on more than five public company boards.

Other Matters. Additional updates to ISS' and Glass Lewis' voting guidelines are summarized below.

- ISS' proposed revisions include a recommendation that shareholders vote against relevant directors at all U.S. companies with unequal voting rights, beginning in 2023; the current policy includes a grace period for companies whose first public shareholder meeting was prior to 2015.
- Beginning in 2022, Glass Lewis will recommend voting against the chair of the governance committee at companies with a multi-class share structure and unequal voting rights if they do not provide for a reasonable sunset — generally seven years or fewer — of the multi-class share structure.
- Glass Lewis will generally recommend in favor of lowering the ownership threshold to initiate shareholder action by written consent if a company does not allow shareholders to call special meetings or only provides shareholders the ability to call a special meeting if they own more than 15% of the company's shares. In addition, Glass Lewis will recommend against lowering the ownership threshold for such a right if a company has an existing 15% or lower special meeting threshold.

Note Current Status of SEC Rules Governing Proxy Advisors

In July 2020, the SEC adopted amendments to its proxy rules that codified the SEC's position that voting advice issued by proxy advisors generally constitute a solicitation under the federal proxy rules and required certain conditions for proxy advisors to qualify for exemptions from the information and filing requirements under the proxy rules. Those new rules were scheduled to be effective as of December 1, 2021.

In July 2021, however, Chair Gensler announced that he requested his staff consider whether the new proxy advisory rules should be amended. In connection with those considerations, the Division of Corporation Finance announced that it would not recommend enforcement action to the commission based on the 2020 rule amendments during the reconsideration period.

On November 17, 2021, the SEC, by a 3-2 vote, proposed further amendments to the rules governing proxy voting advice. Those amendments would rescind two parts of the 2020 amendments — the exemptions from the proxy information and filing requirements and the anti-fraud provisions. As described in the SEC's proposing release, the goal of the proposed amendments is to "strike a more appropriate balance," avoid impairing the timeliness and independence of proxy advisors' voting advice and preserve investors' confidence in the integrity of the advice. The effect of the proposed amendments would be to preserve the current state of play for proxy advisors.

Conditions for Exemptions From the Proxy Information and Filing Requirements

Proxy voting advice provided by a proxy advisor generally is a "solicitation" under the SEC's proxy rules. This long-standing SEC position was codified by the 2020 amendments and was not affected by the new proposal. A solicitation under the proxy rules is subject to information and filing requirements, unless an exemption applies. To qualify for the exemption, the 2020 amendments require, among other things, that proxy advisors adopt and disclose written policies and procedures reasonably designed to ensure that:

- the proxy advisor's voting advice is made available to the subject company at or before the time such advice is disseminated to the proxy advisor's clients; and
- the proxy advisor provides a mechanism by which its clients can reasonably be expected to become aware of the subject company's written responses to such voting advice.

The proposed amendments would rescind those requirements, as well as the related safe harbors and exclusions. The requirement that the proxy advisor disclose material conflicts of interest and steps taken to address those conflicts, added by the 2020 amendments, would remain in place.

Anti-Fraud Provisions

All soliciting material — including proxy voting advice — is subject to the proxy rules' anti-fraud provisions, which prohibit false or misleading soliciting material. The 2020 amendments added to the proxy rules' anti-fraud provisions a note setting forth non-exclusive examples of when failing to disclose certain information in proxy voting advice may be considered misleading. The proposed amendments would rescind that note, although the proposing release reaffirms that proxy voting advice is subject to the prohibition on false and misleading soliciting material. That said, the proposing release notes that the formulation of proxy voting advice often requires subjective determinations and the exercise of professional judgment.

Current Status

Until any action is taken by the SEC regarding the November 2021 proposed amendments, it appears the staff statement that it will not recommend enforcement action to the commission based on the 2020 rule amendments remains in effect. It is possible, therefore, that the approach proxy advisors take for the 2021 proxy season will not be materially different from last year.

Consider Shareholder Proposal Trends and Developments

The 2021 proxy season saw the continuation of certain trends from previous seasons and featured some new developments. Below is a brief summary of observations from the last proxy season that may shed light on what to expect this upcoming season, along with an overview of recent developments relating to Exchange Act Rule 14a-8.

2020 Proxy Season Summary

The number of shareholder proposals submitted to companies this year increased slightly from the prior year — 892 in 2021, up from 857 in 2020 — but was largely consistent with the historical average of 800 to 900 proposals per year. Despite this minor increase, the overall number of proposals that went to a vote decreased from 478 in 2020 to 429 proposals in 2021.

In addition, as has been the case in recent years, large-cap companies were the primary focus of shareholder proposals, with companies in the S&P 500 accounting for roughly three out of every four proposals that went to a vote in 2021.

Environmental and Social (E&S) Proposals. E&S proposals were focal among investors in 2021 and, for the fifth year in a row, outpaced the total number of governance proposals submitted to companies, with 494 E&S proposals submitted compared to 346 governance-focused proposals. Despite the high number of submissions of E&S proposals, more governance proposals (249) ultimately made it onto companies' ballots than E&S proposals (157). A record number (37) of E&S proposals also received majority support in 2021, nearly doubling the amount in 2020 (22).

Environmental Proposals. There were a large number of environmental proposals (149) submitted to companies in 2021, addressing a broad range of topics, including, among others, climate change risks and reporting, greenhouse gas emissions, environmental impact reporting and sustainability reporting. Consistent with a trend from 2020, a relatively small number (46) of environmental proposals ultimately made it to a vote in 2021. Of those that made it on ballots, average support was approximately 37%, slightly more than approximately 32% in 2020. Thirteen environmental proposals received majority support in 2021 compared to eight in 2020.

A substantial subset of the environmental proposals submitted to companies in 2021 related to the specific topic of climate change — about 85 (up from about 60 in 2020). These proposals generally focused on the steps companies were taking to address climate change risks and align their operations or disclosures consistent with the goals of a specific international environmental framework. The number of climate change proposals that went to a vote increased to 24 in 2021 from 13 in 2020, and the average support for these proposals increased to approximately 49% in 2021 from approximately 41% in 2020, with 11 climate change proposals receiving majority support in 2021 (four in 2020). The number of greenhouse gas emissions proposals submitted in 2021 increased slightly (21) from 2020, with only four proposals making it to a vote. However, of the four voted on three received majority support and average support increased to 59.8%, up from 48.4% in 2020. Twenty-two other proposals on other environmental and sustainability matters received average support of 22.7%. These included proposals asking for an annual report on plastic pollution and efforts to eliminate deforestation.

In addition, a new type of proposal, "Say-on-Climate," emerged in 2021, requesting an annual advisory vote on a company's climate-related plans. Four shareholder proposals went to a vote, averaging 28.8% support. Two companies voluntarily adopted "say on climate" in 2021 and agreed to hold a second vote in 2022, and their advisory votes received average support of 99.2%.

Social Proposals. Perhaps not surprisingly, given the cultural climate of 2021, proposals focused on diversity were very popular in the 2021 proxy season. The number of proposals focused on workforce diversity continued to increase, with about 90 submitted in 2021, nearly tripling the amount of the 30 submitted in 2020 — though only about 14% of these proposals went to a vote in 2021. In addition, seven workplace diversity proposals received majority support in 2021, an increase from four in 2020.

In addition to workforce diversity proposals, board diversity proposals remained prevalent, although there were fewer in 2021 (31) than in 2020 (33). While most board diversity proposals submitted to companies were ultimately withdrawn, those that went to a vote in 2021 received average support of 65%, with three proposals receiving majority support in comparison with 2020 where board diversity proposals received average support of 37% with two proposals receiving majority support. One notable variety of board diversity proposal submitted in 2020 sought to adopt a version of the NFL's "Rooney Rule" in searches for new board members and CEOs. These proposals requested that companies adopt a policy mandating that the initial list of candidates considered to fill board seats or to identify a new CEO includes qualified female and racially or ethnically diverse candidates.

In 2021, new proposals also were submitted that requested companies to perform a third-party "racial equity audit" on their operations. Ten of these proposals went to a vote and they averaged 33% support, though none passed.

The number of gender/racial pay gap proposals submitted to companies declined significantly in 2021, with nine proposals submitted compared to 16 submitted in 2020. Proposals focusing on sexual harassment also declined in 2021, with three proposals submitted compared to five in 2020.

About 28 human rights shareholder proposals were submitted in 2021, down from about 45 proposals submitted in 2020. Twelve human rights proposals went to a vote in 2021 and averaged approximately 30% support, relatively consistent with 2020. Those proposals covered a wide range of topics, including, among others, how a company's products, operations or supply chain may violate human rights through hate speech, forced labor and child exploitation. Two of these proposals received majority support, compared with no human rights proposals receiving majority support in 2020.

Proposals relating to corporate political contributions and/or lobbying activities also continued to be popular. While the number of these two groups of proposals declined to 74 from 81 submitted in the 2020 proxy season, average support for the proposals that went to a vote (41) increased from approximately 36% during 2020 to approximately 41% in 2021, and a record 10 of these proposals received majority support in 2020, up from six in 2020. It is possible that these proposals may increase in 2022, driven, in part, by the events of January 6, 2021.

Governance Proposals. Continuing a trend from the 2020 proxy season, a significant percentage of the proposals that went to a vote in 2021 concerned governance-related topics, with 249 out of 429 proposals, compared with 271 out of 478 in 2020. These proposals covered a wide range of topics, including, among others, the ability of shareholders to act by written consent, calls for an independent chair, requests related to shareholders' ability to call special meetings, requests to adopt or amend proxy access rights and elimination of supermajority vote requirements. Fifty-two governance proposals received majority support in 2021, an increase from 47 in 2020.

The most popular governance topic in 2021 was written consent, with 81 proposals submitted, 70 voted on (with a 42% average vote) and 11 receiving majority support, all up from 66 written consent proposals submitted in 2020, 59 voted on (with a 38% average vote) and five receiving majority support. Proposals calling for an independent chair were the second-most common governance topic in 2021, with 35 proposals voted on (compared to 47 in 2020). Average support for independent chair proposals decreased slightly to approximately 31% in 2021 from approximately 35% in 2020, with one of these proposals receiving majority support in 2021 compared to two in 2020.

The third most common governance topic in 2021 related to requests to provide for, or make easier, the ability of shareholders to call a special meeting. The number of special meeting proposals voted on in 2021 decreased to 31 from 44 in 2020, and the average support declined to approximately 34% from 42% in 2020.

In a notable development, all eighteen proposals to reduce or eliminate supermajority vote requirements received majority support in 2021 (compared to ten in 2020), making this type of proposal the governance proposal with the highest number of proposals that passed in 2021. Average support for this type of proposal in 2021 was 86% compared to 65% in 2020.

In addition, as E&S issues continue to take precedence among investors, the lines between E&S and governance have begun to blur. In one example of a new type of governance-related shareholder proposal that relates to social issues, companies in 2021 began receiving proposals requesting that boards take the steps necessary to convert to a public benefit corporation (PBC). Support for these proposals was low, however, with average support of only 3.4%.

Executive Compensation Proposals. The number of executive compensation-related proposals submitted in 2021 declined to 51 from 60 in the 2020 proxy season. The number of executive compensation-related proposals that went to a vote also declined — to 23 in 2021 from 29 in 2020 — and the proposals voted on in 2021 had lower average support of approximately 18% (compared with approximately 23% in 2020). The 2021 proposals covered a wide range of topics, such as requests related to CEO pay ratio, ESG metrics, pay disparity, incentive compensation and clawback policies. No executive compensation proposal received majority support in 2021 compared to two that received majority support in 2020.

SEC Amendments to Rule 14a-8

On September 23, 2020, the SEC adopted amendments to the procedural requirements and resubmission thresholds relating to shareholder proposals submitted for inclusion in company proxy statements pursuant to Exchange Act Rule 14a-8. The amendments, which are in effect for 2022 annual meetings, (i) replace the current ownership requirements with a tiered approach combining the number of shares owned and the length of ownership; (ii) require certain documentation when a proposal is submitted by a representative on behalf of a proponent; (iii) require a proponent to provide information regarding the proponent's availability for engagement with the company; (iv) end the ability of representatives to submit multiple proposals on behalf of other shareholders for the same meeting; and (v) raise the levels of support that a proposal must receive to be resubmitted at future shareholder meetings.[92]

- Notably, the rules provide for an additional transition period to demonstrate eligibility to submit a proposal. Specifically, shareholders who satisfy the $2,000/one-year ownership test as of the effective date of the new rules will continue to be eligible to submit proposals for annual or special meetings held prior to January 1, 2023, provided they continuously hold at least $2,000 of a company's securities from that effective date through the date of submission.

SEC Staff Guidance Rescinding 2017-2019 Guidance

On November 3, 2021, the SEC staff published Staff Legal Bulletin No. 14L (SLB 14L), which explicitly rescinds Staff Legal Bulletin Nos. 14I, 14J and 14K (SLB 14I, 14J and 14K) (issued in 2017, 2018 and 2019, respectively) and effectively resets the staff's approach to the "ordinary business" and "relevance" exclusions for shareholder proposals to the pre-November 2017 approach.[93] As a reminder, the rescinded Staff Legal Bulletins introduced and expounded on the concept of a board analysis to support no-action requests to exclude shareholder proposals relating to the company's "ordinary business" or lacking "relevance." They key takeaways from SLB 14L are as follows.

Significant Policy Exception to "Ordinary Business." The staff will focus on whether a proposal raises issues with broad societal impact such that it transcends ordinary business, rather than the nexus between the policy issue and a particular company. As an example, SLB 14L provides that "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. The staff will take a "measured approach" to micromanagement; proposals seeking detail or seeking to promote timeframes or methods "do not per se constitute micromanagement" and 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." In addition, SLB 14L explains that the staff will not concur with exclusion of climate change proposals that "suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."

Relevance. The staff no longer will entertain a board analysis to consider whether proposal topics falling below the economic threshold of Rule 14a-8(i)(5) raise issues of broad social or ethical concern related to the company's business.

Images. SLB 14L restates guidance from SLB 14I that the use of graphs and/or images to convey information about a proposal is not prohibited by the 500-word rule.

Proof of Ownership Letters. SLB 14L updates suggested proof-of-ownership letter language to account for ownership threshold amendments and expresses a new view that companies should identify any specific defects in the proof of ownership letter, even if the company previously sent a deficiency notice prior to receiving proof of ownership.

- **Use of E-mail.** SLB 14L encourages proponents wishing to submit a proposal by e-mail to contact the company to obtain the correct e-mail address, and for companies to provide an appropriate e-mail address upon request. SLB 14L also encourages senders of e-mail to seek confirmation of receipt from the recipient and for recipients to provide such confirmation when using e-mail to transmit shareholder proposals, deficiency letters and responses to deficiency letters.

[92] See our client alert "SEC Adopts Amendments to Shareholder Proposal Rules" (September 25, 2020).

[93] See our client alert "SEC Staff Issues New Shareholder Proposal Guidance, Rescinding 2017-2019 Guidance" (November 5, 2021).

Comply With Stock Exchange Listing Standards

Related Party Transactions. In August 2021, the NYSE filed an immediately effective rule change incorporating a transaction value and materiality threshold for related party transactions that require independent directors' review.[94] The proposal incorporates those thresholds so that the scope of related party transactions subject to independent directors' review under Section 314.00 of the NYSE Listed Company Manual is aligned with the SEC disclosure rules. As a result of the rule proposal, NYSE-listed companies no longer need to identify and submit for independent directors' review transactions that do not meet the applicable transaction value or materiality thresholds under SEC rules. NYSE-listed companies should still review their policies and procedures for related party transactions in light of the April 2021 amendment requiring "a reasonable prior review and oversight" by the audit committee or another independent body of the board of directors.

Board Diversity. In August 2021, the SEC approved Nasdaq's proposal to amend its listing standards to encourage greater board diversity and to require board diversity disclosures for Nasdaq-listed companies.[95] Subject to transition periods and limited exceptions, Nasdaq-listed companies will be required to (i) publicly disclose board-level diversity statistics on an annual basis using a standardized matrix template under Nasdaq Rule 5606 and (ii) have, or disclose why they do not have, a minimum of two diverse board members under Nasdaq Rule 5605(f). See the section titled "Consider Recommendations To Increase Board and Workforce Diversity and Enhance Related Disclosures" for additional information.

Voting Standards. In November 2021, the SEC approved the NYSE's rule proposal to the SEC to amend Section 312.07 of the NYSE Listed Company Manual to provide that a company must calculate "votes cast" on a proposal subject to that section in accordance with its own governing documents and any applicable state law.[96] This rule change results in the NYSE and Nasdaq having similar treatment of abstentions. In particular, Nasdaq's FAQ clearly states: "Nasdaq does not define the term 'votes cast.' As such, a company must calculate the 'votes cast' in accordance with its governing documents and applicable state law."

The amendment applies to shareholder votes required for equity compensation plans, stock issuances for related party transactions, stock issuances of 20% or more and changes of control. To prepare, companies should carefully review the voting standards that apply in their governing documents and under state law, as well as the company's descriptions in SEC disclosures, including proxy statements.

[94] See the SEC's "Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending the Term 'Related Party Transactions' Under Section 314.00 of the NYSE Listed Company Manual" (August 26, 2021).

[95] See the SEC's "Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, To Adopt Listing Rules Related to Board Diversity and To Offer Certain Listed Companies Access to a Complimentary Board Recruiting Service" (August 6, 2021).

[96] See the SEC's "Notice of Filing of Proposed Rule Change To Amend the Shareholder Voting Requirement Set Forth in Section 312.07 of the NYSE Listed Company Manual" (September 29, 2021).

Plan for Another Year of Virtual Shareholder Meetings

During 2021, many public companies continued to hold virtual annual meetings, with Broadridge alone hosting nearly 2,000 virtual shareholder meetings during the first half of the year.[97] Looking ahead, due to the uncertainty relating to COVID-19, companies should prepare for the possibility of needing to hold virtual annual meetings during the 2022 proxy season.

Lessons From 2021 Virtual Meetings

Companies have continued to successfully hold virtual annual meetings and allow investors to participate, although some companies experienced difficulties with technical issues during the meetings. To prevent these issues from occurring this upcoming season and to learn how virtual annual meeting platforms have changed since the 2021 proxy season, companies should engage early with virtual meeting service providers. In addition, companies should consider investor feedback regarding their 2021 shareholder meetings when drafting related proxy statement disclosure and planning for their next meeting.

Proxy Advisory Firm and Investor Group Perspectives

In accordance with a policy that became effective in February 2021, ISS generally recommends voting in favor of management proposals to allow virtual shareholder meetings, as long as the proposal does not preclude in-person meetings.[98] Glass Lewis believes that virtual access to an annual meeting can be a "useful complement" to attending a meeting in person and expects companies to provide "robust" proxy disclosures regarding shareholders' ability to participate in virtual or hybrid meetings.[99] However, despite proxy advisory firm support for hybrid shareholder meetings, some investors remain concerned about a lack of transparency surrounding virtual meetings — in particular, virtual-only meetings — and if the severity of the pandemic continues to subside, investor opposition to such meetings may increase.[100]

SEC Guidance

The virtual annual meeting guidance that the staff of the SEC's Division of Corporation Finance issued in April 2020, as the COVID-19 pandemic began, continues to apply to such meetings.[101] The guidance noted that companies should clearly disclose logistical details, such as how shareholders can remotely access, participate in and vote at the meeting, and how companies should disclose changes to an annual meeting, such as switching from an in-person to a virtual meeting.

Shareholder Participation

According to Broadridge, during the 2021 proxy season, 95% of companies hosting a virtual annual meeting on Broadridge's platform allowed live questions from shareholders, and 98% of companies that held meetings on the platform did not provide an in-person option to partic-

[97] See Broadridge's "Virtual Shareholder Meeting — Make Your Next Shareholder Meeting a Meeting of Minds" (2021).

[98] See ISS' "United States — Proxy Voting Guidelines" (November 19, 2020).

[99] See Glass Lewis' "2022 Policy Guidelines" (November 15, 2021).

[100] See the Council of Institutional Investors et al.'s "Virtual and Hybrid Meetings: Concerns From 2020 Proxy Season" (July 6, 2020), stating in a letter to the SEC that virtual meetings held in 2020 were a "poor substitute" for in-person meetings and that companies should provide shareholders a more straightforward means of accessing, participating in and voting at the meetings.

[101] See the SEC's "Staff Guidance for Conducting Shareholder Meetings in Light of COVID-19 Concerns" (April 7, 2020).

ipate.[102] Companies should consider the manner in which they will provide for shareholder participation and include related disclosure in their proxy statements.

State Law Requirements

Companies considering holding a virtual annual meeting in 2022 should review their state corporate laws covering the ability to, and permissible methods of, holding virtual annual meetings or switching from an in-person to a virtual annual meeting. The majority of states, including Delaware, permit companies to hold virtual-only shareholder meetings, and in 2021 a number of states adopted amendments to permit virtual-only or hybrid annual meetings.[103] However, for the states that do not permit virtual-only meetings, such as New York (which provided emergency relief due to COVID-19), the availability of any relief is uncertain for 2022 annual meetings. Companies should therefore monitor developments in their state of incorporation concerning relevant statutory changes or new executive orders and should review their governing documents to ensure they allow for virtual meetings.[104]

[102] See Broadridge's "Virtual Shareholder Meeting — Make Your Next Shareholder Meeting a Meeting of Minds" (2021).

[103] On August 24, 2021, New Jersey adopted amendments to Section 14A:5-1 of the New Jersey Business Corporation Act to permit New Jersey companies to hold annual meetings solely by means of remote communication, subject to certain shareholder participation and verification requirements.

[104] Nasdaq requires that shareholders are "afforded the opportunity to discuss Company affairs with management" at most companies' annual meetings. See Nasdaq's "IM-5620. Meetings of Shareholders or Partners" (May 28, 2019).

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