SHEARMAN & STERLING

2022 Proxy Season Quick Reference Guide

The 2022 proxy season is just around the corner. This quick reference guide, which is intended to supplement Shearman & Sterling's 19th Annual Corporate Governance & Executive Compensation Survey, summarizes themes from the 2021 proxy season and developing trends to consider for 2022. It also identifies possible future changes in disclosure rules that public companies should consider for the upcoming proxy season.

RAPID CHANGE

The last few years have required boards of directors to face a rapidly changing business environment, tackling a range of matters, from a pandemic, to the "great resignation", to scandals, such as those associated with the "MeToo" movement, to increasing frequency and sophistication of cyberattacks. These events have resulted in boards more closely examining whether they have the tools and people in place to respond rapidly and effectively to key issues facing the company for which they have oversight responsibility. The modern board, one ready to operate successfully in this environment, has taken a number of steps that distinguish it from the boards of only a few years ago.

Some of these changes are structural, such as the use of technology to enhance communication between the board and management, as well as establishing processes that allow the board to act rapidly. Additional changes include an increased time commitment on the part of directors and a deeper engagement on new matters such as corporate strategy, culture and the impact of new technologies on the organization's business.

Boards are also looking at their composition to identify any areas in which they may be lacking sufficient expertise. For example, cybersecurity being an area of risk that many boards find themselves under-equipped to address. Recruitment efforts are also increasingly focused on board diversity, as institutional investors continue to strongly push boards on this issue.

DIVERSITY

In recent years diversity has become an increasingly important issue for investors and other stakeholders. In August, Nasdaq's board diversity rule was finalized, requiring Nasdaq listed companies to reach and maintain diverse board representation (or disclose if not achieved) and annually disclose board diversity statistics in a matrix format. The disclosure is required by the later of August 8, 2022 and the date the Nasdaq listed company files its 2022 proxy statement, whereas the diverse representation requirement is effective for the largest companies as early as 2023 proxy season. Our August 2021 memo provides detail on the requirements of the Nasdaq board diversity rule. Companies should also be on the lookout for disclosure rules from the SEC on board diversity, which are on the spring SEC agenda and be aware of states enacting board diversity requirements, including California, Illinois and New York, to name a few, and how those laws may impact their board composition.

Institutional investors, including State Street, Goldman Sachs and Blackrock, have updated their 2022 guidelines. These include recommendations on diverse board representation, disclosure of diversity statistics and, in certain instances, disclosure of consideration of diverse candidates. ISS and Glass Lewis have also released their board diversity and disclosure requirements for the 2022 season. Companies that fail to meet these guidelines risk a no vote recommendation on all or select committee members. To ensure compliance, companies may want to review their D&O questionnaires to ensure they are collecting all necessary diversity data and inform directors and officers that the information will be disclosed.

Finally, shareholders are interested in more than just board diversity. Wide reaching diversity proposals from shareholders have been increasing and companies are becoming more responsive. Last year, we saw many diversity related shareholder proposals on disclosure of EEO-1 reports, diversity initiatives and racial equity audits.

SHAREHOLDER PROPOSALS & ESG ACTIVISM

The 2021 proxy season evidenced significant gains for activist shareholders who had unprecedented success promoting ESG proposals, most notably in the case of ExxonMobil where a new hedge fund with a 0.02% stake garnered the support of the largest institutional investors and public pension funds to elect three directors, a quarter of the board, displacing incumbent directors. Such unparalleled shifts in large institutional investor backing were paired with broadened proxy advisor

ESG voting policies. ISS and Glass Lewis, for instance, announced new policies in 2021 that include director accountability for ESG governance failures. The SEC has also widened the gates for activist shareholders, most recently by adopting a universal proxy rule and new interpretations of the shareholder proposal process that is expected to limit the basis for which companies may exclude certain shareholder proposals, particularly those focused on ESG topics.

To meet these challenges, boards should ensure they are well-informed on issues affecting their business and proactively engage with shareholders. Regular briefings by management, including ESG as a recurring topic on board and committee agendas, seeking directors with ESG experience, assigning ESG as an area of oversight to a specific committee and even forming standalone ESG committees are becoming the standard. All stakeholders will hone in on companies with boards that do not appear to be meaningfully overseeing a company's approach to ESG. Significantly, some investors now take the position that weak ESG programs are an indication of weak oversight at the board level in general, particularly with respect to risk management. A recent Delaware decision that allowed a case to proceed against Boeing on claims of board oversight failure, adds to the importance of having strong board oversight. Showing a willingness to engage with shareholders and actively keep up with the rapidly evolving developments can serve as a strong defense against these challenges.

THE IMPACT OF THE "E'S" OF EESG

We have seen enhanced focus on employees, evidenced by the recent addition by some of an extra "E" to ESG to recognize the importance of employees. This year's ISS Americas Policy Updates reflect heightened scrutiny regarding how effectively companies disclose efforts to address "EESG".

The ISS annual Global Benchmark Policy Survey showed increased desire among investors for the use of more non-financial ESG metrics in compensation programs, with a preference for their use in creating long-term incentives. Companies that include ESG metrics in their compensation programs should provide transparent disclosure on how and why such metrics were chosen. Informing stakeholders how companies are promoting ESG-driven values remains a key consideration for the upcoming proxy season. Companies should also consider how the ESG focus impacts their human capital management disclosures in their Form 10-K.

On the climate change front, the SEC is moving quickly toward new requirements on climate-related disclosure, requesting public comments for potential climate change disclosure that generated overwhelming support for streamlined disclosure mandates, establishing a Climate and ESG Task Force to identify material gaps or misstatements in issuers' disclosure of climate change risk, and including a proposed rule on its regulatory agenda that would create new climate change disclosure requirements. The SEC is developing a comprehensive disclosure framework that produces "consistent and comparable" information and provides "decision-useful" information to investors, companies should be proactive and explicit in disclosing efforts to address climate risk.

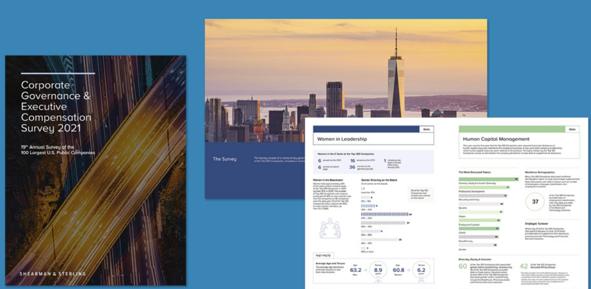
CLAWBACK REBOOT

Recently, the SEC re-opened the comment period on its long-tabled proposed clawback rule as required under The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank").

As described in our perspective, the proposal would require companies to recoup incentive-based compensation received by current and former executive officers in the event of an accounting restatement. One important nuance of the proposed rule is that the restatement need not result from fraud or misconduct by the issuer or its employees. The SEC's requests for comment sheds light on its plans for this proposal, such as whether a clawback should apply to nonmaterial errors and the triggering event for the three-year lookback period.

Should the rule be finalized, companies will be subject to additional disclosure obligations, required to file their clawback policy and disclose their actions to enforce the clawback policy.

Given the SEC's renewed attention to clawbacks, companies should continue to monitor the proposal and view their policies in light of the proposals, requirements. In the six years since the proposal, many companies have implemented clawback policies, which may or may not comply with the SEC's anticipated requirements. In addition to revisiting clawbacks, another potential Dodd Frank reboot may be in the works as the long-awaited pay for performance rules are on the SEC's agenda.



Shearman & Sterling's 19th Annual Corporate Governance & Executive Compensation Survey

Please also see our 19th Annual Corporate Governance & Executive Compensation Survey, where we review the major themes from the 2021 proxy season and analyze the associated data to provide detailed insights for the coming proxy season. A copy is available here.

Proxy Drafting and Annual Meeting Housekeeping Checklist

- **Corporate Governance and Executive Compensation Highlights**. Consider how to craft an executive summary of the company's proxy and CD&A that is a visually appealing and compelling communication. Keep it specific for the biggest impact. Highlights may include diversity and equality initiatives, significant governance changes, good governance practices, workforce relations priorities, enhanced diversity representation on the board and in the executive ranks, significant compensation actions taken in 2021 and other ESG matters.

- **Director Matrices**. Consider updating the director skills matrix to ensure that a balanced set of attributes, skills and experiences are included beyond the traditional set of business-oriented ones, such as experience with ESG-focused areas like sustainability/environment, human capital matters and cybersecurity/data privacy. Consider adding diversity attributes.

- **Corporate Governance Guidelines**. Review Corporate Governance Guidelines and consider updating for board diversity and sustainability considerations. Conduct a review of the Compensation Committee Charter and Nominating and Governance Committee Charters to ensure that they appropriately allocate responsibility among the board committees for human capital matters and director compensation. Consider incorporating diversity considerations into director nominee attributes in the Nominating and Governance Committee Charter, in addition to similar disclosures that may be included in the proxy.

- **Compensation Committee Independence**. Review the compensation committee members' independence under NYSE and Nasdaq listing standards, ISS's affiliated outside director test and under Section 16 of the Securities Exchange Act.

- **D&O Questionnaires**. Ensure D&O questionnaires are up to date and include questions regarding board demographics, including information needed to complete director diversity matrices. Update the questionnaire to inform officers and directors how the information will be used.

- **Equal Pay**. Ensure that pay practices and policies comply with state equal pay legislation and consider whether major shareholders want to better understand gender and racial pay parity policies. Shareholder proposals seeking racial equity audits made some headway in 2021. These proposals seek an independent look at the impact of certain company policies on racial equity. Companies should prepare for increased shareholder engagement on this issue.

SPOTLIGHT

Coordinate Internally on Disclosure and Communication

- Internal coordination is becoming increasingly important as more and more similar information is needed for inclusion in the Form 10-K, proxy statement and other CSR/ESG reports. For example, many ESG and human capital topics cross over between reports.
- The "publishing date" for each of these filings and reports are usually different and often the drafting and data collection timelines differ too. In addition, the owners of these filings and reports and the related data collection may involve people in different internal functions (i.e., legal, financial reporting and human resources).
- Consistency across reports is of the upmost importance for the company. Early planning and coordination, and possibly acceleration of the data collection for later filings or reports, should be considered.

Looking Ahead

The SEC has recently proposed various rules that may impact a company's proxy disclosure practices in future years.

Companies should begin to think about how proposed rules on 10b5-1, clawbacks, and share repurchases, to name a few, may impact their future reporting seasons. Our recent publications should also be helpful SEC Proposes Significant Changes to Rule 10b5-1 Plans and Introduces New Disclosure Requirements and SEC Proposes New Disclosure Rules for Share Repurchases.

Proxy Drafting and Annual Meeting Housekeeping Checklist (cont.)

- **Perquisite Disclosure**. Review perquisite disclosure. Inaccurate perquisite disclosure has resulted in an increased number of SEC enforcement actions in recent years. The mere fact that a benefit is provided for a business reason is not sufficient to conclude that the benefit is not a perquisite. To the extent applicable, ensure compliance with the SEC's guidance on COVID-19 perquisite analysis.

- **Clawbacks**. The SEC recently reopened the comment period on its proposed rulemaking on clawbacks. While we do not expect final rules for this upcoming proxy season, it may be worthwhile to review whether the company currently has any forms of compensation clawback in place, what incentive programs they cover, whether employment agreements should be amended to incorporate clawback policies and whether the voluntary policy would comply with the proposed rule as drafted. The prevalence of voluntary clawback policies, which act as a risk mitigator, has been on the rise, but some of those may not fully comply with the proposed rule. For companies without a clawback policy, it may be time to begin to consider the issues surrounding the implementation of one.

- **ESG Performance Metrics**. For companies that include ESG metrics in their incentive plans, make sure appropriate disclosure is provided, including a thorough description of how qualitative ESG performance metrics will be assessed.

- **Equity Plan Adoptions or Amendments**. If adopting or amending an equity compensation plan, make sure that any disclosure complies with Item 10 of Schedule 14A and that the plan provides adequate limits on director compensation (including any cash compensation).

- **Alternative Pay Disclosures**. Consider whether to include alternative pay disclosures— such as realized or realizable pay—being mindful that shareholders may ask questions to the extent these disclosures are omitted or modified in future years.

- **Pay Ratio Local Impact**. Companies doing business in San Francisco, California should consider whether Proposition L would apply. Proposal L has created an additional tax on gross revenues of companies engaged in businesses in San Francisco where its pay ratio exceeds 100 to 1.

- **Shareholder Engagement**. Consider how you are describing engagement efforts in the proxy statement, particularly where voting results from the last annual meeting indicate developing investor concerns. Companies are increasingly providing more details about shareholder engagement efforts in their proxy statement summaries. ISS expects a robust response to say-on-pay proposals that received less than 70% support. ISS will consider the relationship of the company's pay and disclosure changes to the feedback received.

- **Spring Loaded Compensation Awards**. The SEC recently provided guidance on how to account for and disclose equity compensation awards granted shortly before certain MNPI is released.

SPOTLIGHT

Non-Employee Director Compensation

- Recently, there has been a focus on non-employee director compensation and when it may be viewed as excessive.
- ISS may issue adverse voting recommendations for board members when there is a recurring pattern of excessive pay without a disclosure of mitigating rational.
- Companies may want to review their non-employee director compensation structure. Setting limitations on both cash and equity is generally viewed favorably.

Proxy Drafting and Annual Meeting Housekeeping Checklist (cont.)

- **Stock Ownership Policies**. This year, ISS updated its guidance on stock ownership policies, where it will no longer credit policies that count unearned performance awards or unexercised options for ownership.

- **Institutional Investor and Proxy Advisory Firm Guidelines**. Review updates to the voting policies of applicable major investors, ISS and Glass Lewis. ISS compensation policy changes for the 2022 season have recently been released that should be considered when preparing for this proxy season.

- **Cybersecurity and Data Privacy**. Describe in the proxy statement which committee of the board has cybersecurity and data privacy risk management responsibility and how that risk is managed. The SEC has recently sought enforcement action on inadequate disclosure controls, which we discuss in more detail in "The SEC Double-Clicks on Cybersecurity".

- **HSR Thresholds**. Use proxy preparation time to check on compliance on other matters, like executive HSR thresholds (2022 thresholds are expected to be published in early 2022).

- **Hedging Policy Disclosure Rules**. Hedging policy disclosure has now been required for a few proxy seasons; even for those companies without a hedging policy in place. The SEC may begin to take a closer look at these disclosures.

- **Non-GAAP Financial Measures**. To the extent included in the proxy, including the CD&A, other than with respect to performance target levels, disclosure requirements regarding the use of non-GAAP financial measures (explanation and reconciliation) must be met.

- **Related Party Rules**. For NYSE listed companies, the definition of "related party transaction" was recently revised to be back in line with Item 404 of Regulation S-K. Confirm appropriate definition is being used to bring it back in line with.

SPOTLIGHT

Emerging Growth Companies – Say-on-Pay

- Emerging Growth Companies (EGCs) can provide more limited disclosure while they maintain EGC status.
- EGCs do not need to hold a say-on-pay vote. Once a company is no longer an EGC, they must hold a say-on-pay vote no later than:
  - Three years after IPO (if EGC for less than two years after completion of IPO); or
  - One year after losing EGC status for all other EGC issuers.

Links to Institutional Investors' Most Recently Published Proxy Voting Guidelines

- Amundi
- Blackrock
- Capital Group
- Cohen & Steers
- Fidelity
- Goldman Sachs
- J.P. Morgan
- Janus Henderson Investors
- State Street
- T. Rowe Price
- Vanguard
- Wellington

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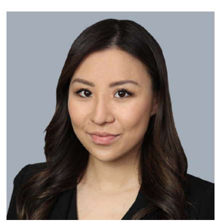

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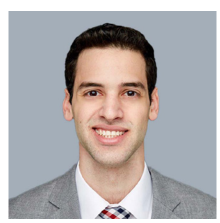

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