Shearman
SHEARMAN & STERLING
17TH ANNUAL SURVEY OF THE
100 LARGEST U.S. PUBLIC COMPANIES
CORPORATE
GOVERNANCE &
EXECUTIVE
COMPENSATION
SURVEY
2019

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INTRODUCTION

Concern for environmental and social issues has reached an inflection point. While traditional governance issues that have been a staple of investor advocacy and discussion (the "G" of ESG) continue to be important, environmental and social issues (the "E" and the "S" of "ESG") have now taken center stage. Scarcely a day passes without a new ESG development, disseminated as a statistic, an investor campaign, political initiative or action by a special interest group. In response to this change, the 2019 Corporate Governance & Executive Compensation Survey, our 17th annual, closely reviews several aspects of the current ESG phenomena in addition to continuing to report on traditional governance topics. In this effort, we cover such topics as proxy access, shareholder engagement, shareholder proposals, governance practices of newly public companies, CEO pay ratio, director compensation, cybersecurity, board diversity and shareholder activism.

The topic of ESG is a complex one for companies, raising a broad range of issues. In this Survey, we strive to help companies develop their approach and framework to the issues that are relevant to them.

We also provide insights on specific E&S issues, including human capital management, gender pay disparity, board diversity and corporate culture. Across all topics, our goal is to provide an overview of the current corporate governance landscape and identify best practices.

In addition to insights articles, the Survey consists of a review of key governance characteristics of the Top 100 Companies, which we define as the 100 largest U.S. public, non-controlled companies that have equity securities listed on the NYSE or Nasdaq, measured by market capitalization and revenue. A list of the Top 100 Companies can be found in "The Survey" section at the end of this publication. The results of the Survey can also be found in "The Survey" section as well as in the insights articles contained elsewhere.

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THE FORCES DRIVING ESG

It is instructive to identify the forces that have been driving, and that are expected to continue to drive, the ESG movement.

- Institutional investors have prioritized ESG and seek to engage with companies with respect to core ESG matters
- ISS and Glass Lewis have indicated that they will make voting recommendations based on particular ESG positions taken by companies
- ESG research and ratings firms have proliferated in response to the desires of investors and other stakeholders to measure ESG performance of companies
- ESG standard-setting bodies have continued to emerge, offering potential paths to greater standardization of ESG reporting
- ESG activism continues to rise and has been characterized by support from special interest groups, institutional investors and employees
- Although the U.S. federal government and the SEC have not been particularity active in this area, state governments and European countries have been catalysts for change

THE FOLLOWING STATISTICS SERVE AS A TESTAMENT TO ESG PROLIFERATION:

Over

86%

of the S&P 500 have published sustainability reports[1]

Signatories to the Principles for Responsible Investment (PRI) reached 2,232 in 2018, a

21%

increase on the previous calendar year[2]

Over

25%

of the $88 trillion assets under management globally are now invested according to environmental, social and governance principles[3]

181

corporate members of the Business Roundtable, including 56 of the Top 100 Companies, issued a statement that seeks to redefine the long-held view that corporations exist to serve shareholders and maximize profits to expand the constituencies to whom corporations answer. The statement includes shareholders, but adds customers, employees, suppliers and communities as stakeholders to whom companies owe a commitment[4]

Similar to 2017 and 2018, the aggregate number of E&S shareholder proposals submitted in 2019 **exceeded the number of G (governance) proposals[5]**

[1] *See* Flash Report, Governance & Accountability Institute, "86% of S&P 500 Index Companies Publish Sustainability Reports in 2018" (May 16, 2019).

[2] *See* Principles for Responsible Investment, "PRI Signatory Growth Shows Strong Momentum" (January 2019).

[3] *See* State Street Global Advisers, "Aim Higher: Helping Investors Move From Ambition to Action With ESG Investment Approaches" (October 2, 2018).

[4] *See* Press Release, Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'" (August 19, 2019).

[5] *See* Institutional Shareholder Services, "Early Review of 2019 U.S. Proxy Season Vote Results" (June 5, 2019).

KEY ESG QUESTIONS

The following are some of the key ESG questions that we think will continue to shape ESG discussions:

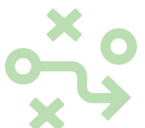
1 Does the company have a dedicated team that is focused on the relevant ESG matters for the company?

2 Are ESG matters integrated into the company's and board's consideration of long-term strategy and enterprise-wide risk?

3 Is the board being adequately informed about how the company is handling ESG matters? Is the board equipped to properly oversee management in this area?

4 Does the company prepare ESG-related reports and does the company follow an established ESG reporting standard? Does the company integrate ESG matters into its SEC reports? Does management apply the same rigor to the preparation and review of these reports as it does to its public reporting? Does the company engage with ESG ratings firms?

5 What ESG engagement activities does the company conduct? Are directors able to engage with investors and other stakeholders on ESG matters?



We encourage you to use the Survey to consider how your company's approach to ESG fits within current trends and what steps your company should take to develop its ESG practices, to benchmark your corporate governance and compensation practices against those of the Top 100 Companies, and to consider our perspectives and practical guidance on what are no longer emerging, but in fact emerged, topics.

Please reach out to a member of our team to discuss any matters contained in the Survey or to learn more about the Shearman & Sterling Corporate Governance practice.

INSIGHTS

ESG has reached global recognition with stakeholders from all corners, including investors, employees, customers, governments and other constituencies, focusing on some or many of the issues that comprise the topic.

INSIGHTS

Stephen T. Giove, Richard B. Alsop, Lona Nallengara, Bill Nelson and Judy Little

THE CLIMATE CHANGES FOR ESG

The focus on ESG matters has increased considerably in the past few years. Most leading companies are now devoting significant resources to developing and refining their approach to addressing, and explaining to stakeholders, the environmental, social and governance (ESG) matters that are significantly related to their business. Despite this increased focus, there is still considerable divergence in how companies define, address and disclose ESG matters for a variety of reasons. First, there are no precise boundaries as to what issues fall within the ESG rubric. No list or single source defines the scope of ESG. Second, ESG issues are not static — new ones emerge and existing ones evolve over time, which requires companies to consider how these issues will be addressed and spoken about with stakeholders on an ongoing basis. Finally, the importance of a particular ESG issue can vary considerably across companies, industries and geographies. What is important for one company may not be as important for another. For better or worse, there is no uniform solution for approaching ESG matters. As a result, each company needs to evaluate and define which ESG issues are core to its business, determine which ESG issues resonate with its stakeholders and establish a plan to address these issues and communicate them to stakeholders.

On one end of the spectrum, there are companies that do not factor ESG considerations into their decision-making, do not engage with shareholders and other constituencies on ESG matters and do not make any ESG disclosures beyond those that are required to be disclosed under applicable SEC rules. These companies, for example, include customary disclosures related to climate change and environmental matters as part of their risk factor, business, regulatory and litigation disclosures and may make limited disclosures on diversity as part of director disclosures in the proxy statement. Companies on the other end of the spectrum have fully integrated ESG considerations into their strategic planning and risk management processes, have dedicated ESG staffing, regularly engage with shareholders and other stakeholders on ESG matters and make sophisticated ESG disclosures, not only in SEC filings but also in specialized reports that receive significant board attention and external promotion. Most companies fall somewhere in the middle of this spectrum. Wherever a company falls on the spectrum, it is becoming increasingly difficult for a board to let the management team ignore the ESG issues that are important to the company. The increased focus of investors, customers and employees, coupled with a growing body of research demonstrating that companies that focus on sustainability and other ESG issues tend to outperform peers that do not, makes it imperative that boards direct management to engage on ESG and ensure that the board does so itself.

In this article, we identify some of the common issues faced, and some of the practical next steps to be considered, by companies planning their next steps in their evolving approach to ESG.

DETERMINING ESG SCOPE

One of the most difficult threshold challenges for companies seeking to establish a comprehensive approach to ESG is setting the scope of engagement. This is usually an iterative process involving a wide cross-section of management and often with board involvement. A number of factors are relevant in determining which ESG issues a company should focus on and prioritize. Determining the scope is critically important so that the company can set expectations, establish appropriate goals, plan and implement actions to achieve these goals, measure success over time and, where appropriate, publicly report on progress.

Typically, a discussion of the scope of a company's ESG efforts includes a discussion of materiality. While many ESG issues that are important to a company and its constituencies are not material when viewed through the traditional financial materiality lens, some of these can be critically important to a company over the long-term with implications for the company's business in a way that does not necessarily translate neatly into short-term financial metrics. For example, the focus on a particular ESG issue by an important constituency, such as large institutional shareholders or employees, can significantly escalate the importance of the issue to the company. Additionally, clients and customers and the public generally are increasingly raising concerns that may affect a company's ESG agenda, and ignoring these voices can result in direct financial and reputational harm.

Look at Strategy and Risks

One of the most important factors in determining the scope of the company's ESG focus is analyzing which issues are important to the success of the company's long-term business strategy and the management of the significant risks facing the company in pursuing that strategy. As noted above, this involves viewing the company's business strategy and risk assessment through a wider lens than traditional financial materiality. Boards and management should consider how environmental, social and sustainability issues impact the company's ability to achieve its long-term strategy. This is a complex analysis, but it is not much different than how boards tackle any new risk or problem or brainstorm on future challenges and opportunities.

As it does with any new risk, the board should better understand how an ESG issue can be an obstacle to long-term objectives. First, the company must understand and prioritize what its core ESG issues are — for example:

- How could climate change impact the company's long-term prospects?
- How could a better-trained workforce help grow the company's anticipated new business lines?
- How could better childcare resources in the communities in which the company operates create new opportunities?

Look to Industry

Each company will have unique ESG focuses based on numerous factors, such as its size, geographic location, investor base and employee composition, but industry-wide trends will be important guideposts as to where a company needs to be focused. Monitoring news about industry peers and evaluating their SEC reports and voluntary disclosures can be valuable tools in establishing the scope for a company's approach to ESG. Most companies will be "graded" against objective standards by which they will also be compared to others in their industry.

Look to Shareholders

An increasing number of shareholders have viewpoints on ESG issues. Nearly all of the largest institutional shareholders (and not just the public pension funds) have publicly communicated the importance of ESG to them (and their clients) and, in many cases, have prioritized certain key issues. Many institutional investors are producing detailed reports that outline their ESG investing priorities. These reports are important sources on the issues that institutional investors care about, but, more importantly, they provide an important perspective on how institutional investors think about these issues and what level of engagement they expect. As with many other mainstream issues that boards, general counsels and corporate secretaries have had to address, many ESG issues start from a kernel planted by an issue advocate that grows over time. Keeping a close eye on what is developing in the shareholder proposal cycle, watching how shareholder voting is changing and keeping abreast of the issues that advocates are speaking about will help prepare companies for the issues that may be next on the board's agenda.

Look to Employees

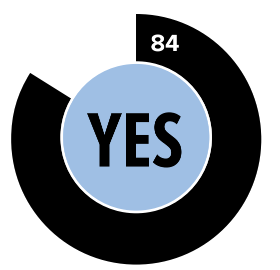
We are in an era where the actions of employees can have a significant impact on decisions made in the boardroom. Employees not only care about issues that relate to the employee-employer relationship, such as the absolute levels of pay, gender pay equity, employment conditions and terms and policies regarding paid leave, but also care about the "corporate citizen" they work for. Employees are increasingly selective about where they work because they want the company they work for to, in some degree, share their values. And we see this in some of the recent "employee activism" when a company's actions appear to veer from what the company's employees believe are their shared values. Whether it is employees challenging their company's unwillingness to adopt a policy that can promote board diversity or decisions to continue commercial relationships with the federal government that are viewed as indirectly supporting controversial programs, employee activism is on the rise. And it is getting more powerful. Value or mission statements do not seem to be enough for employees unless there is something behind them. Ignoring the perspective of employees could be short-sighted in the current environment. It can impact recruitment and retention and employees can often serve as a good barometer for public sentiment. Seeking the input of employees and, better still, involving employees in the company's ESG efforts can only strengthen the company's efforts.

Look to the Community

ESG covers a broad cross-section of issues. The ones that are global in nature, like reducing greenhouse gas emissions, water management plans and workers' rights, have widespread coverage by institutional investors and issue advocates and will be the ones employees read about in the media. It is also important to understand that some ESG issues are local. How does a company impact the communities in which it operates and where its employees live? These include living wage issues, support for public education, decisions related to property and physical plant and community-based activities. It is important to understand the role the company can play in the important issues affecting its communities and not to lose sight of local issues when evaluating its global strategy.

DOES THE CORPORATE SOCIAL RESPONSIBILITY (CSR) REPORT CONTAIN A LETTER FROM THE CEO?

Given the focus on ESG by a company's various constituencies, it has become commonplace for the company's CSR Report to contain one or more letters from senior management, including a letter from the company's CEO



ESG ENGAGEMENT

ESG engagement has become a significant focus for companies, as the largest institutional investors are lending their financial clout to calls for leadership by the largest public companies on a variety of environmental and social issues, and a growing number of institutional investors are taking ESG disclosures into account in their investment decisions. Global equity values have achieved dizzying heights over the last few decades, driven by technological innovation, and the related increase in the size and influence of companies around the world has led to a recognition that meaningful environmental, social and economic change can be fueled by the largest public companies, both because of their sheer size and the influence they will have on practices of other, smaller companies, as well as their ability to move faster and more effectively than governments. As BlackRock's Larry Fink noted in his 2018 letter to CEO's, "Society is increasingly looking to companies, both public and private, to address pressing social and economic issues." And it appears companies are listening. In August 2019, the CEOs of 181 U.S. companies, many of the largest public companies in the world, issued a statement through the Business Roundtable that seeks to redefine what had been the long-held purpose of a corporation – to serve shareholders and maximize profits.[1] The statement offers that while each company has its own corporate purpose, all companies are a fundamental commitment to customers, employees, suppliers and communities along with delivering long-term value to stakeholders.

Reasons to Engage with respect to ESG Matters

Given these lofty expectations, companies and their boards are increasingly focused on identifying material ESG-related risks and opportunities, integrating ESG considerations into their culture, long-term strategy and operational plans, and developing an effective communication program that highlights this commitment and shows progress against particular goals. At the same time, companies are increasingly recognizing that thoughtful consideration of ESG issues and implementation of an ESG strategy will produce important benefits, including improved shareholder relations, protection against shareholder activism, demonstration of risk awareness and, most importantly, a pathway to creating long-term shareholder value.

Developing the Company's ESG Message

Identifying a clear message that will resonate with a company's stakeholders is critical. One of the key considerations is the type of information that should be provided to shareholders and other constituencies. In its February 2019 report entitled "Change the Conversation: Redefining How Companies Engage Investors on Sustainability,"[2] Ceres, a sustainability organization, advised companies to disclose "decision-useful information," which for Ceres means connecting sustainability and other ESG issues important to the company to financial performance, strategy and risk management. Many investors connect their thinking on ESG issues to more traditional concepts of profitability and risk. This approach is consistent with the growing view that ignoring sustainability and other ESG issues puts short-term profitability ahead of long-term shareholder value.

[1] *See* Press Release, Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'" (August 19, 2019).

[2] *See* Ceres, Change the Conversation: Redefining How Companies Engage Investors on Sustainability (February 6, 2019).

Identifying the Audience

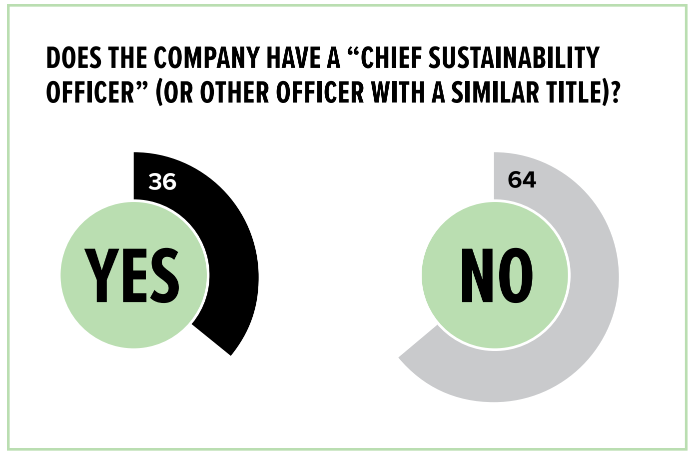
Institutional investors are increasingly incorporating ESG data into their investment decisions, or communicating their expectations to companies in their portfolios. ESG disclosures are therefore naturally designed to address existing and potential shareholders. It is important, however, for companies to have a broader view of the possible audience for their actions and disclosures. In light of the broader non-financial implications of these disclosures, companies should take into account the many other constituencies that will read and evaluate this information as well. These include ISS and Glass Lewis, which have integrated ESG reporting into their proxy advisory reports, special interest groups that use shareholder proposals to target specific ESG-related issues, entities that rate the ESG actions companies undertake and entities that set ESG standards which companies can use to assess their progress and structure their reporting. Additionally, depending on the issue involved, federal, state or local governments and government agencies may take a keen interest in the disclosures. Employees, customers, suppliers and local communities are also important constituencies to consider, particularly in an era where social media can cause perceived corporate missteps or omissions to go "viral." These factors put a premium on determining the shareholders and other stakeholders that want or should want to hear about a company's ESG message and prioritizing the key constituencies the company needs to engage.

The ESG Engagement Team

How the ESG message is communicated is a key consideration. The medium and the people delivering the message are both important. The spokespeople need to have credibility, which comes from both knowledge of the issues and responsibility within the company. Knowledge includes understanding what the company and its peers are doing and the relevant best practices. Responsibility means that those who are selected to represent the company will be seen as speaking for the company. Increasingly, this is a team effort, including senior legal, investor relations and subject matter experts. In addition, there are increasing requests by investors and others for director participation on core issues.

Direct Engagement

Most companies are familiar with the traditional investor roadshow. Whether it is the pomp and circumstance of an annual investor day, presentations at investor or industry conferences or road trips to visit one-on-one with key investors, companies know the focus of these meetings and presentations historically have been on financial performance, business strategy and outlook for the company in the coming months and years. Similar meetings with institutional investors solely focused on company-relevant ESG issues are becoming more and more common. Some institutional investors have built dedicated teams with real subject matter knowledge and market experience to engage substantively with companies. These meetings or roadshows, which can be in person or by teleconference, are entirely focused on ESG issues. Often, these meetings are requested by investors and other stakeholders, but companies that have a good story (or a new one) may even seek out these meetings or ESG conferences to deliver their message. These dedicated meetings require careful planning and high-level attention.



ESG RATINGS

As attention to ESG matters has grown, so has the importance of having a strong ESG profile. This has led to the growing influence of ESG rating firms. ESG rating firms are third parties that evaluate and rate the performance of public companies (and some private companies) on a range of ESG standards. Institutional investors and other stakeholders are increasingly turning to rating firms to assist them as they evaluate the ESG practices of the companies. As more and more capital is directed toward ESG investing, ESG ratings are becoming more consequential.

There are numerous rating services and they all use their own methodology to establish how well a company performs against their own ESG classifications. As many of the ESG issues do not provide quantifiable metrics or standardized disclosures, the interpretation of a company's ESG "data" can be significantly different among different rating firms. Unfortunately, this has sometimes led to the same company having different ratings from different firms.

Many rating firms look only to a company's public disclosures, such as SEC filings, ESG reports or other information on the company's website. Other rating firms supplement the company's disclosures with other sources of public information about the company and its ESG practices such as filings with governments or other regulators, press reports and other third-party reporting. Some rating firms seek input from the companies to determine ratings so as to ensure they have all relevant information, including information that the company has not disclosed. Other rating firms only evaluate based on publicly disclosed information, with some taking the perspective that disclosing this type of information is indicative of the change that is being fostered.

This last point is important to understand. As the influence of rating firms has increased, so has the desire to understand what the rating firms look at, how they collect the information and what influence a company can have on its score. This has led many companies to unpack rating firms' methodologies to understand the important inputs in order to devise ESG practices and, more importantly, ESG disclosures to align with what the rating firm is looking at all in an effort to get a higher rating, but does not necessarily reflect change in ESG commitment or actual improvement of practices. Additionally, many companies take seriously, devoting time and resources, inquiries from rating firms seeking to understand a company's ESG profile. For these companies, spending the time to present the full (or best) ESG profile is worth it if ultimately ratings are better.

Boards cannot ignore ESG ratings either. Boards should know the important rating firms and the company's ratings. Directors should understand how ratings were formulated, what company disclosures were used in the assessment, where the company rated poorly and what management is going to do about the rating. Furthermore, boards should probe to make sure the company is developing credible ESG practices and not focused only on increasing ratings.

ESG RATING FIRMS

Bloomberg ESG Data Service

Bloomberg has been providing ESG data through its Bloomberg Terminal since 2009. Users have access to ESG data on the ESG dashboard of the Bloomberg terminal, including key ratios and the most important performance indicators and can compare ESG and financial performance across companies. Bloomberg collects, verifies and shares ESG data from more than 11,500 companies in 83 countries. Bloomberg rates companies on a scale that is out of 100, which is based on a company's annual disclosure of quantitative and policy-related ESG data, and also provides scores from third-party rating agencies (RobecoSAM, Sustainalytics, ISS Quality Score and CDP Climate Disclosure Score) and an overview of a company from an ESG perspective both historically and relative to peers.

DowJones Sustainability Index (DJSI)

DJSI, launched in 1999, tracks the performance of companies in terms of economic, environmental and social criteria. Approximately 4,500 companies from among 10,000 companies in the S&P Global Broad Market Index are invited to participate in an annual industry-specific questionnaire, and responses are scored according to each multi-factor ESG index in a rating scale out of 100. A rules-based selection of the top 10% most sustainable market cap companies per industry, based on their sustainability scores, are included in the DJSI index each year.

ISS E&S Disclosure QualityScore

ISS E&S Disclosure QualityScore provides a platform to measure the quality of corporate disclosure on environmental and social issues, including sustainability governance and climate change. Disclosure practices are assessed based on industry groups, and specific environmental and social risks are identified by industry and multi-stakeholder initiatives as well as reflected by other ESG standards such as GRI, SASB and TCFD. Rating scores are based on decile scores of 1–10 that analyze raw score calculations of peer companies within the same industry group. ISS E&S Disclosure QualityScore provides a score that measures the depth and extent of disclosure of a company's environmental and social risks and preparedness, as opposed to ranking its ESG initiatives and actions taken.

MSCI ESG Research

Launched in 2010, MSCI ESG Research evaluates ESG risks, including daily monitoring of 2,100 media publications and regular updates of public documents and third-party data sets. Its ESG Ratings cover over 6,800 companies. Rating scale is from AAA to CCC, which is based on an assessment of 37 ESG key issues.

Sustainalytics Company ESG Reports

Sustainalytics was formed in 2008. Currently, its ESG ratings cover 11,000 companies. Sustainalytics focuses on financially material risks to company performance, provides an assessment of how well the company is managing these risks and provides absolute ratings that enable comparisons across industries and companies at the overall ESG and issue-specific risk levels. Rating scale is out of 100, ESG indicators are organized by each industry and each indicator is given a specific weight depending on each industry to assess the most financially material risks.

Thomson Reuters ESG Research Data (Refinitiv)

Refinitiv provides ESG data and scores for over 7,000 global companies with data since 2002 and analyzes based on over 400 metrics. Rating scores are based on percentile rank scores that assess ESG performance across 10 main themes (emission, environmental product innovation, human rights, shareholders, etc.), including data-driven weights placed on certain ESG indicators and an overlay that discounts scores for impact of significant ESG controversies specific to a company or industry.

ESG DISCLOSURES

Most of the ESG reporting by public companies falls into the voluntary category, rather than being mandated by the SEC or other government entities. This has been the source of considerable criticism by institutional investors due to the lack of comparability, the tendency to focus on positive ESG efforts and the lack of metrics that may reflect slower progress. As a result, there have been calls for the SEC to mandate ESG disclosures, which have so far gone unheeded.

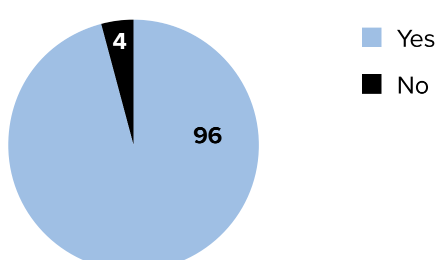
SEC Perspectives

In 2010, the SEC issued guidance on climate change reporting that summarized some of the ways existing rules and regulations could give rise to disclosure obligations under the federal securities laws, including material impacts of climate change-related legislation and regulation, international accords, climate change-related business trends or opportunities and physical impacts, but it stopped short of mandating climate change disclosures.[3] In 2018, a coalition of academics and institutional investors petitioned the SEC for rulemaking[4] to develop a standardized comprehensive framework under which public companies would be required to disclose identified ESG factors relating to their operations. No action has been taken on that petition. In recent public comments,[5] the Director of the SEC's Division of Corporation Finance referenced the 2010 guidance as a useful framework for evaluating a broader category of ESG issues but expressed caution with respect to mandating specific ESG disclosures, noting that to publish rules might interfere with market-driven solutions and stifle efforts to develop useful disclosure frameworks. Despite the absence of SEC-mandated ESG disclosures, companies and their disclosure committees should not lose sight of the fact that in some instances, such as the examples set forth in the 2010 guidance, there are affirmative disclosure obligations under the current SEC framework relating to ESG issues such as risks and trends or the impact of related regulation where that information would be material to investors.

"Corporate Social Responsibility" Reports

Most large public companies are preparing reports touching on relevant ESG-related topics, particularly in certain public consumer-facing industries and industries with widespread environmental impact. These have most commonly been dubbed "corporate social responsibility" reports but the nomenclature is evolving, with more examples incorporating words like "sustainability," "citizenship" and "impact." Companies have an array of options for these reports — from a single comprehensive report that covers a broad range of ESG issues to a few separate single-issue reports. Understanding how the company will use the report and how investors and other stakeholders will engage with it should dictate the company's approach. If there is a critical issue for a company or industry, it may be advisable to create a separate report or a supplement to the full report to highlight efforts and successes in this area. Delivery of the report should also be an important consideration. As most of the readers of the report will be accessing it online, think about how technology can be used to strengthen and amplify the communication. Video, interactive pages and detailed data output are all becoming more common.

DOES THE COMPANY ISSUE A CSR REPORT?



IS THE CSR REPORT ISSUED AS A SINGLE REPORT OR IN MULTIPLE REPORTS?

85
Single report

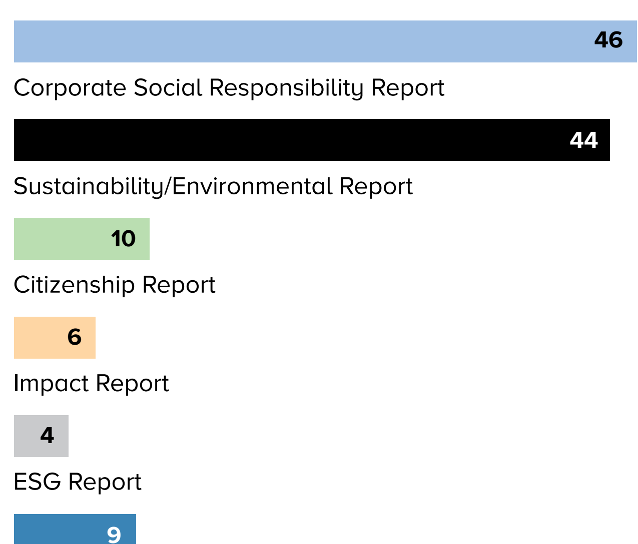
11
Multiple reports

[3] *See* SEC, Commission Guidance Regarding Disclosure Related to Climate Change (2010).

[4] *See* Rulemaking Petition to the SEC (October 1, 2018).

[5] *See* William Hinman, Director, SEC Division of Corporation Finance, Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks (March 2019).

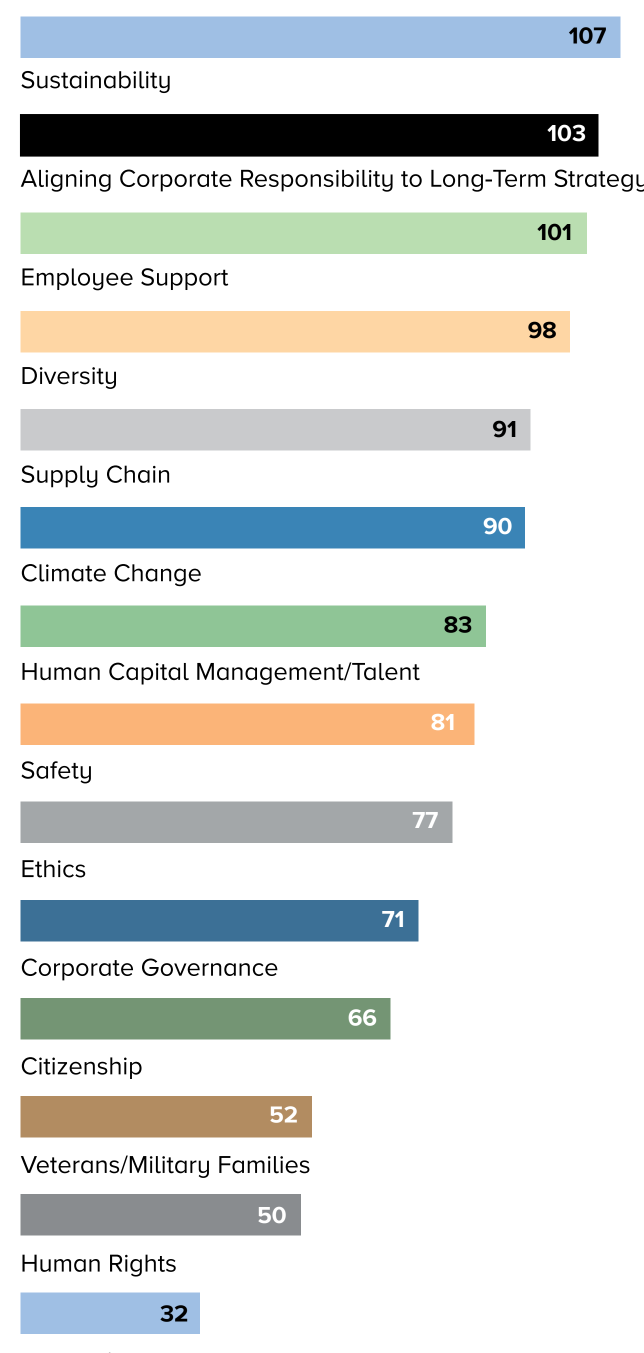
NAME OF THE CSR REPORT*



* A total of 119 reports were published by the Top 100 Companies. 85 of the Top 100 Companies published one report, six published two reports, three published three reports, one published four reports and one published five reports.

There is considerable variation in the nature and content of ESG reports that companies publish. This makes sense as each company must identify the ESG issues most relevant to it based on the nature of its business, strategy and risk perspective, its industry and geographic footprint, the perspective of its customers, employees and the communities in which it operates and the investors that own its stock. The real challenge is creating a coherent message so that the associated reports and multimedia will facilitate stakeholder engagement across a broad range of constituencies. Some companies do this with multiple reports that each address a different area, while other companies create a single document that comprehensively speaks to the importance of the relevant issues. Engagement with stakeholders to understand what they are looking for will be important to find the right format. Most companies also make a substantial effort to provide numerical results and multi-year performance metrics against specific goals.

WHAT TOPICS ARE COVERED IN THE REPORT?



Proxy Statement Disclosures

The annual proxy statement can be a valuable medium for communicating the board's engagement on ESG issues. It provides an opportunity to explain what ESG issues are important to the company and how the board is overseeing ESG matters. The company can also provide details regarding the board's oversight in the descriptions of the responsibilities of board committees. Disclosures around risk management should also reflect how boards consider relevant ESG issues. For some companies, where ESG issues are particularly important for long-term growth, director nomination factors may include knowledge and experience with the relevant ESG issues. Additionally, boards may wish to consider whether performance metrics for executive compensation should also be tied to achieving targets related to ESG matters. If so, integration through disclosure in the "Compensation Discussion and Analysis" section would demonstrate this commitment.

Annual Report Disclosures

The company's Annual Report on Form 10-K can also be a vehicle for enhanced ESG messaging. Although we are a long way away from incorporating ESG metrics in financial reporting that is central to an Annual Report, investors and other stakeholders are increasingly looking for more integration between financial and sustainability reporting. They want to see that a company's approach to its core ESG issues is part of its business strategy. There are a few small steps that can be taken to ensure that the ESG message delivered in specialized reports is reflected in periodic reporting:

- Consider whether the discussion of strategy is consistent with the ESG message that is delivered in the sustainability reporting
- Consider whether known trends and uncertainties disclosures required in "Management's Discussion and Analysis of Financial Condition and Results of Operations" should address environmental and other sustainability issues
- Revisit environmental risk disclosures to ensure that the tone is consistent with the perspective the company is taking with respect to these risks

REPORTING STANDARDS

Several global reporting frameworks provide guidelines and metrics for companies to measure and assess their sustainability initiatives. Reports based on these metrics provide valuable information to a wide range of stakeholders, including investors, suppliers, employees, customers and regulators who are increasingly focused on environmental and social topics and their governance.

GRI

The Global Reporting Initiative (GRI), established in 1997, developed the first corporate sustainability reporting framework and is used by the majority of companies reporting sustainability information today. GRI standards include a broader scope of disclosure than most other frameworks.

SASB

The Sustainability Accounting Standards Board (SASB), established in 2011, provides standards for sustainability information that are designed to be financially material to investors. SASB standards are also specifically identified by industry type or sector, and are currently available for 77 different industries. SASB standards are geared towards companies and investors that are focused on analyzing the material sustainability factors that are likely to impact the financial performance of the company, as well as developing standards for disclosure of material sustainability information to investors in SEC filings.

TCFD

Task Force on Climate-related Financial Disclosures (TCFD) is a global group established by the Financial Standards Board (FSB) at the 2015 G20 summit, in response to a request from the G20. TCFD developed a set of voluntary climate-related financial disclosures designed to be applicable to organizations across industry sectors and jurisdictions to help identify the information required by investors, lenders and insurance underwriters to appropriately assess and price climate-related risks and opportunities.

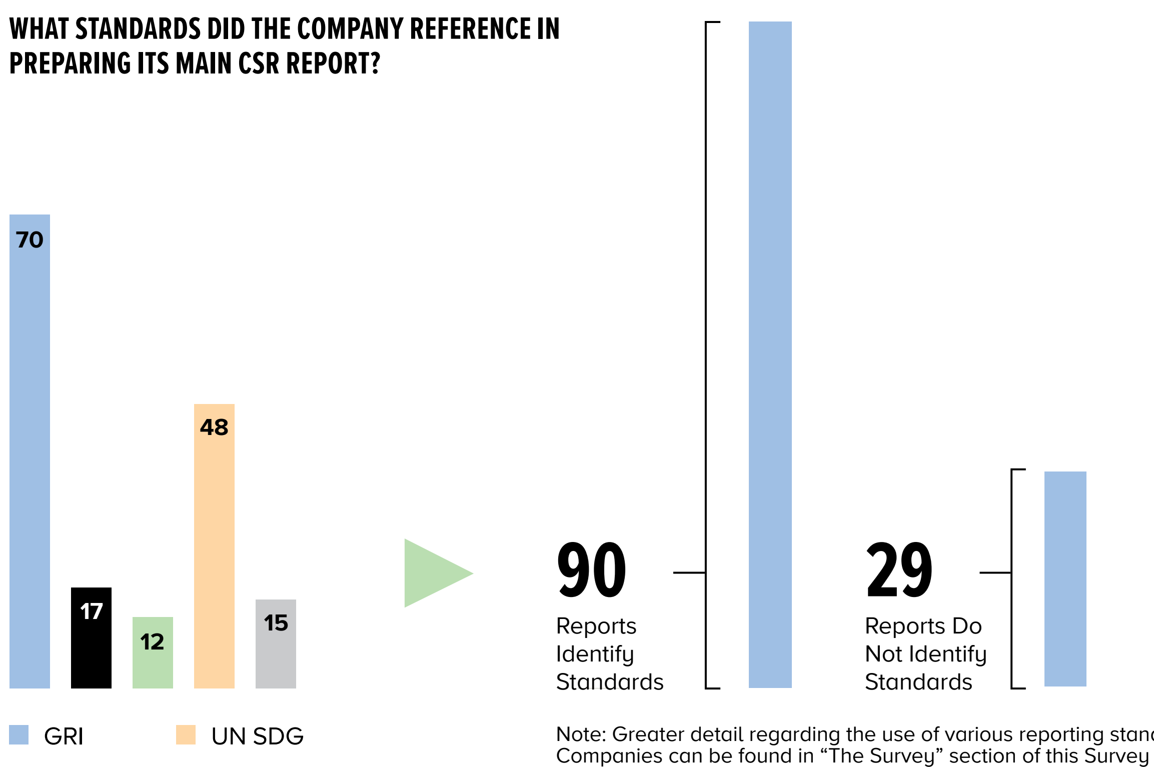
United Nations Sustainable Development Goals

The United Nations Sustainable Development Goals (UN SDG) are a collection of 17 goals, further developed into 169 targets, adopted by the United Nations Generally Assembly in 2015 for the 2030 Agenda for Sustainable Development. The UN SDGs are a shared blueprint for addressing the most pressing challenges the global community faces, including those related to poverty, inequality, climate, environmental degradation, prosperity and peace and justice.

United Nations Principles for Responsible Investment

In 2006, the United Nations launched the Principles for Responsible Investment (PRI), which was signed by the heads of leading institutions from 16 countries, representing more than $2 trillion in assets. PRI has specifically aligned their recommended actions with the UN SDGs, highlighting how advancing the UN SDGs are related to sound investment decision-making, capital allocation strategies, corporate governance practices and assessment of the risk landscape. The six overarching principles of the PRI, which are voluntary, are underpinned by a set of 35 possible actions that institutional investors can take to integrate ESG considerations into their investment activities.

WHAT STANDARDS DID THE COMPANY REFERENCE IN PREPARING ITS MAIN CSR REPORT?



Note: Greater detail regarding the use of various reporting standards by the Top 100 Companies can be found in “The Survey” section of this Survey under the heading “ESG Disclosure and Governance.”

ESG DISCLOSURE PROCESS MATTERS

Given the significant attention that CSR reports receive from many different constituencies, the accuracy and tone of the report is critically important to ensure the report is consistent with the company's intended message. As CSR reports are voluntary disclosures, in some companies they are not subjected to the rigor of the review, inter-departmental vetting and auditing process that mandated SEC filings are routinely given. Companies often take quite different approaches to the creation and review of the reports. It is essential that companies be thoughtful in designing a process that has the same kind of integrity and quality that is applied to other important corporate disclosures. Many companies integrate the review process with existing functions, such as presentation and review by the disclosure committee that provides oversight for SEC reporting. In any case, irrespective of what process is chosen, it should be a thorough and formal one. The review of a CSR report cannot be relegated to the "other report" category that gets a cursory review by a disclosure committee or similar body. It is important to ensure involvement of all relevant internal stakeholders, including financial reporting, legal and investor relations. Although there may not be rules mandating disclosures, the impact of saying the wrong thing or forgetting to say something in an ESG report could be significant.

Establishing an ESG Reporting Process

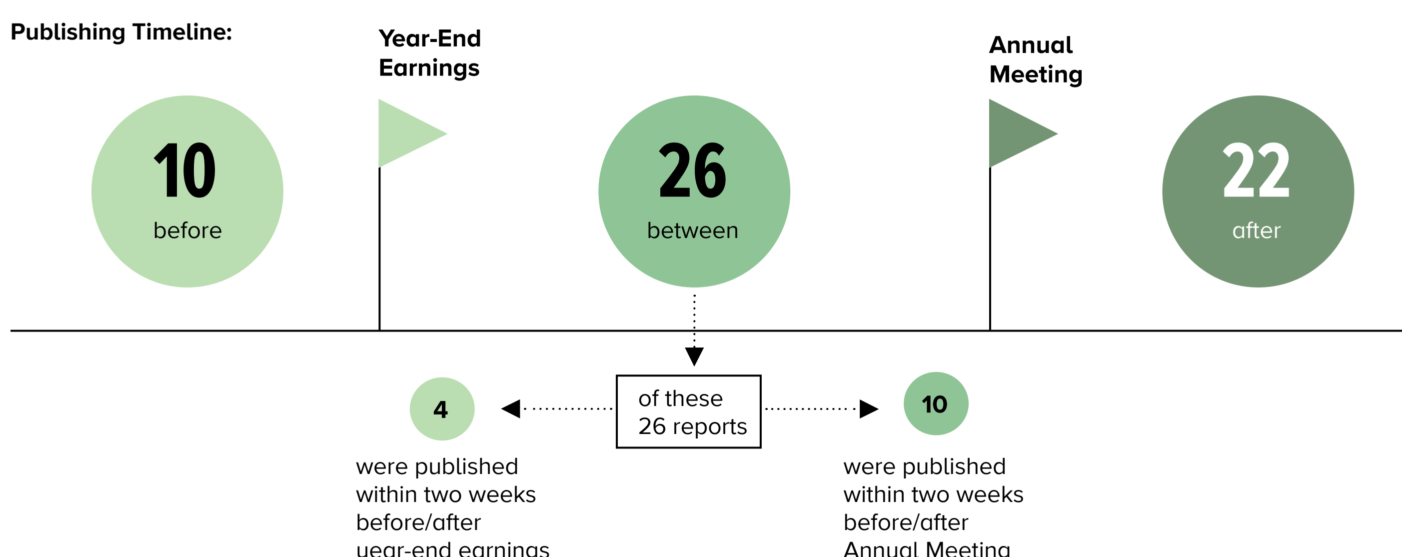
There is not a one-size-fits-all approach to ESG reporting, but companies should be thinking about the following factors as they develop their approach:

- Define the material ESG issues that are relevant to the company's business and should be incorporated into the report
- Identify the third-party standards that make the most sense for the company to use, and consider the approaches being taken by other companies in the industry
- Develop a formal plan for creating and building the "communications vehicle" for the company's ESG message on an annual basis, which can be a website with interactive components, a report or series of specific-issue reports, a series of investor presentations, an ESG roadshow or all of these things. Consideration should be given to the time during the calendar year when this communication refreshes for the maximum impact, such as integration with the annual reporting cycle (annual report/proxy statement)
- Establish a formal vetting process that integrates review by key internal stakeholders and ensures accuracy and engagement
- Create a process to get directors up to speed on the significant ESG issues for the company and create a process for meaningful board engagement and oversight
- Develop processes for obtaining feedback from investors and other key stakeholders

Release of ESG Reports

Part of the decision-making process regarding ESG communications is deciding when to publish your CSR report and whether to issue a press release announcing such release. While a number of Top 100 Companies do not indicate the date their CSR report is released, 40 of the 58 Top 100 Companies for which there was a release date issued their CSR reports within the period beginning two weeks prior to their announcement of earnings and ending two weeks after their annual meeting. Issuance of CSR reports in this window suggests a degree of coordination and integration between traditional financial reporting and ESG reporting.

WHEN IS THIS REPORT MADE PUBLIC?

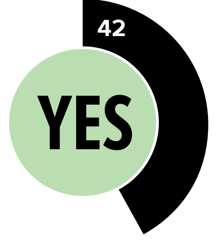


Of the 58 Top 100 Companies for which it could be determined when they issued their main CSR Report,

36 issued their reports prior to their annual meeting, and

22 issued their reports after their annual meeting

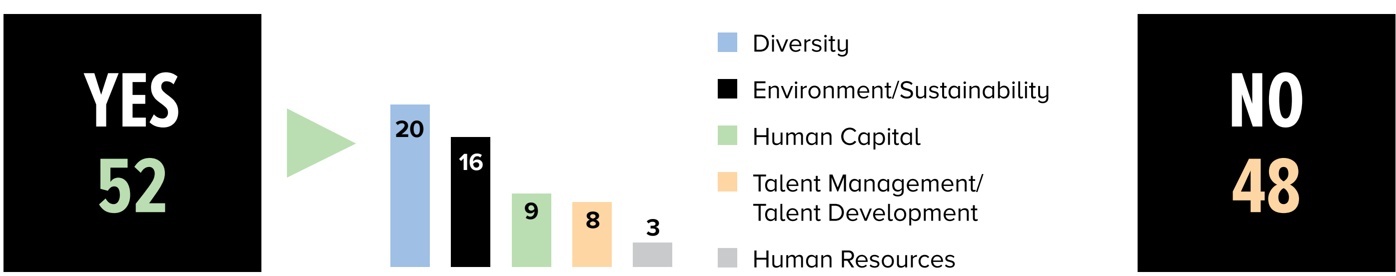
DOES THE COMPANY ANNOUNCE THE POSTING OF THIS REPORT IN A PRESS RELEASE?



Potential Liability

CSR reports, while not subject to the same liability as filings made with the SEC, may still give rise to liability, or at least litigation costs, if not properly reviewed. Investors may make claims against public companies for inaccurate ESG disclosures under the antifraud provisions of the federal securities laws, whether or not such misstatements and omissions are contained in SEC-filed documents. Care should be taken to ensure that statements do not cross the line from aspirational goal-setting to overt puffery, or worse, material misrepresentation. ESG reporting has also led to investigations by state attorneys general and municipalities. Additionally, shareholders may bring claims against directors where inaccuracies are perceived to have stemmed from a failure of oversight. All of this signals that companies should not segregate ESG reporting in a place that sits outside of a company's public reporting review structure.

DOES THE PROXY STATEMENT IDENTIFY ESG FACTORS AS A SKILL SET IN THE DIRECTOR SKILLS MATRIX OR NARRATIVE DESCRIPTION?**



** Some companies included more than one ESG factor as a skill set in their director skills matrix or narrative description.

ESG INTEGRATION

The degree to which ESG considerations are integrated into a company's existing strategy setting, risk management and disclosure processes is a major differentiator between companies with well-developed approaches to ESG and those that do not. Senior management teams and corporate boards have meaningfully increased their focus on ESG matters and are actively exploring ways to integrate ESG issues into all of their existing processes. Key questions include:

Does the company, both management and the board, consider ESG issues as part of its long-term strategy and its risk management review?

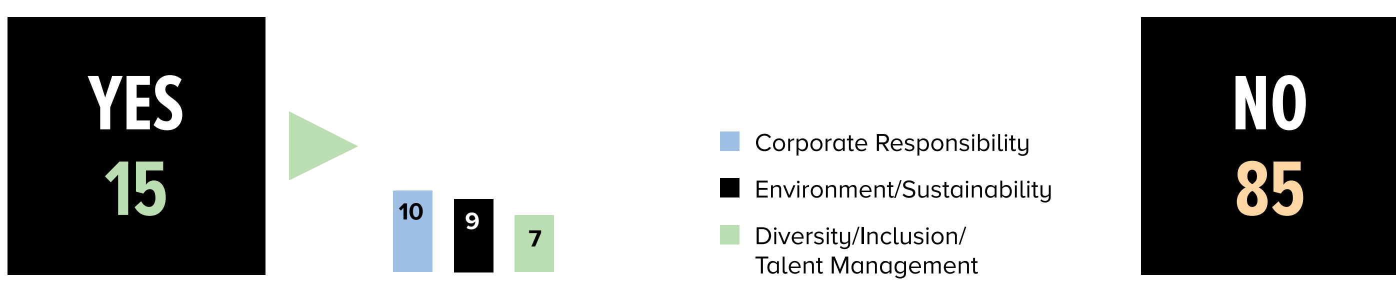
Is the ESG management team involved in the strategic planning processes?

How integrated are the company's ESG and non-ESG disclosures?

Are any of the company's compensation incentive metrics based on ESG?

How is the ESG function staffed at the company, how senior is the head of ESG at the company and to whom does the head of ESG report?

ARE ESG FACTORS CONSIDERED IN LONG- OR SHORT-TERM COMPENSATION METRICS?***



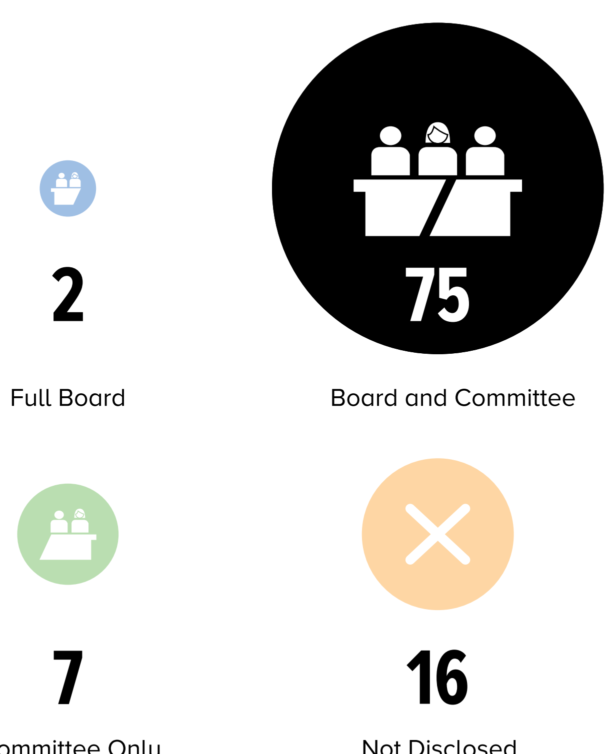
*** Some companies considered more than one ESG factor in their short- or long-term compensation metrics.

BOARD OVERSIGHT OF ESG

Board-Level Discussions

To what extent does the full board discuss ESG matters? Is ESG a separate topic on the board's agenda or does it form a real part of the board's discussion regarding financial outlook, strategy, risk, culture and executive compensation? Some companies schedule time on the board agenda to discuss ESG issues and may even devote a full board meeting to ESG topics. The perspective of those who advocate for integrated reporting of financial and operational information with ESG is that integrated reporting starts with integrated thinking. This means that management and the board do not allocate specific time for "an ESG discussion," but have ESG form part of the dialogue that management has on a day-to-day basis about the financial, operational and risk issues that arise, and the board does the same when it meets to discuss higher-level matters. The right spot on this continuum for most companies is likely somewhere in between, which means thoughtfully integrating ESG considerations as part of a company's ongoing risk management and strategy discussions, but also allocating time for the company to consider developing issues on a regular basis.

HOW DOES THE BOARD ALLOCATE RESPONSIBILITY FOR ESG OVERSIGHT?



Committee Responsibilities

Which board committees have responsibility for ESG? Given the significant responsibilities of the audit and compensation committees of most boards, responsibility for ESG oversight is more frequently the responsibility of the nominating and governance committee or another committee, such as a public affairs or corporate social responsibility committee. A common approach is for the nominating and governance committee to oversee ESG matters given the overlap between ESG and traditional governance matters and engagement. As ESG engagement increases, there is likely to be an increased expectation on boards to have one or more directors directly participate in such engagement with shareholders and other interested constituencies.

COMMITTEES RESPONSIBLE FOR ESG OVERSIGHT****

53

Nominating and Governance Committee

32

Public Policy/Regulatory and Compliance/Sustainability Committee

5

Audit Committee

4

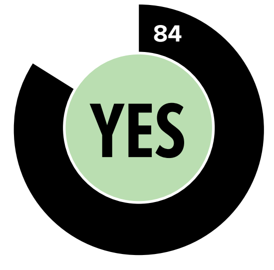
Compensation Committee

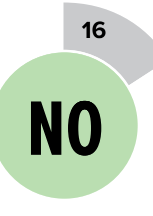
**** Based on a review of proxy statements, committee charters and corporate governance guidelines; of the 82 of the Top 100 Companies that disclosed which board committee(s) had responsibility for ESG oversight, nine of the Top 100 Companies had two or more committees responsible for such oversight.

Disclosure of Board Oversight

Disclosure of the board's oversight of ESG matters is typically found in three places — the company's proxy statement, its reports on ESG matters and its corporate governance documentation. While there is no specific proxy statement requirement to discuss ESG oversight, companies have begun to disclose the board's approach to ESG oversight and the key ESG issues the company is focusing on. Some companies cross-reference or provide a link to additional ESG reporting available on their corporate website. The website often provides information about who in senior management has responsibility for ESG matters as well as some details regarding senior management and board interaction on ESG matters. Finally, the company's corporate governance guidelines and its committee charters often provide insights into how the board oversees ESG matters, including the coverage of the full board and individual board committees. Given the increased importance of demonstrating the board's commitment to ESG, companies have been considering changing the names of their committees to more directly indicate where ESG matters are being handled at the board level.

DOES THE COMPANY DISCLOSE ITS BOARD'S OVERSIGHT OF ESG MATTERS IN ITS PROXY STATEMENT?





IS ESG OVERSIGHT DISCLOSED IN COMMITTEE CHARTERS OR CORPORATE GOVERNANCE GUIDELINES?

MEASURING SUCCESS

It is often said that you measure what is important. Setting goals and measuring the results of an ESG initiative is a critical step in establishing the company's focus. Measurement provides a company with the means to judge the success of its initiative and provides investors and other constituents with the ability to assess a company's progress over time. The credibility of a measurement is greatly enhanced if the measure is reported on a consistent basis, is calculated in a manner that is comparable to the calculations performed by other companies and is publicly disclosed.

Shareholders
Success with shareholders can be measured in various ways. A company's shareholder engagement process can provide the company with real insights into the company's approach and performance with respect to ESG matters, indicated by candid discussions and feedback and reduction in shareholder proposals. Several large institutional shareholders have made it quite clear that ESG is a top engagement priority for them.

Ratings
As ESG ratings continue to proliferate, the information used to set ratings protocols and complete evaluations is limited, but it is getting better. As more and more companies provide ESG disclosures and drive their own disclosures to get better ratings, the information available to raters is improving. As the quality of the ratings improves, so will the influence and importance of a rating firm and a positive rating. Improving a rating is one of the more objective ways to measure success.

Employees and Customers
Success can also be measured in other less direct ways. Employees and customers can provide feedback on how a company is addressing ESG issues and, perhaps more importantly, whether the company's ESG message is getting out to the right people in the right way. Feedback can be seen in employee or customer surveys that focus on specific ESG issues or broader connection with corporate values. Employee recruitment and retention rates should not be overlooked as indicators of how a company's ESG message is being received.

Absence of Negative Events
The absence of the occurrence of a "bad" event, such as an employee action, protest or strike, a customer boycott or regulatory investigation, the avoidance of exclusion from stock market indices or ESG-focused funds, the decrease or elimination of ESG-focused shareholder proposals as compared to peers and improved employee satisfaction and decreased employee turnover are all items which can, at least in part, be attributed to improved ESG performance.

Accolades and Recognition
A company's ESG performance can also be evaluated by the accolades or recognition it receives as well as through its accomplishments — both the achievement of the goals it has set as well as by taking a leadership in their industries.

INSIGHTS

Doreen E. Lilienfeld and
Matthew H. Behrens

CLOSING THE GENDER PAY GAP

From Wall Street to the soccer pitch, public interest in addressing the gender pay gap is greater than ever. While the press covers the U.S. Women's World Cup team's struggles to earn equal pay for equal (or, rather, superior) work, ESG-focused investors are demanding more granular disclosure of companies' efforts to close the gender pay gap. Companies that fail to address gender pay inequality may not only see reputational damage, but may find themselves at a competitive disadvantage as talent migrates to those companies that prioritize fair pay and opportunities for career advancement. Companies that do not keep up face the risk of potential legal action, as well as shareholder and consumer backlash.

This article analyzes recent developments in the gender pay gap debate and offers practical advice to companies confronting deficiencies in this area.

THE GENDER PAY GAP AS AN OPPORTUNITY GAP

Here are the facts: In 2019, the median pay for women is 21% less than the median pay for men or, put another way, women earn only 79 cents for every dollar earned by a man.[1] When factoring in race, the gap grows even larger. For each dollar earned by a white man, a white woman earns 80 cents while American Indian, Alaska Native, black and Hispanic women earn just 74 cents. By its nature, a "median pay" comparison is derived without regard to job type, seniority, location, experience or other similar factors. When applying an "equal pay" measure that controls for the same position and qualifications, the gap shrinks substantially — such that white women earn 98 cents for every dollar earned by a white man while non-majority women with similar educational and other qualifications earn 97 cents for every dollar earned by a white man.[2]

The large median pay gap compared to the smaller "equal pay gap" serves to illustrate that the gender pay gap may be more properly characterized as an "opportunity gap." For example, while 75% and 74% of men and women, respectively, start their careers as individual contributors (i.e., they do not manage others), by late career, 57% of men are managers or higher while only 41% of women reach managerial ranks. As discussed below, shareholder proposals on gender pay are evolving in light of investor recognition that the gender pay gap reflects a failure to promote women to, or hire them for, jobs with more responsibility that are higher paying.[3]

IN 2019, "EQUAL PAY DAY" WAS APRIL 2 — THIS DAY MARKS THE ADDITIONAL MONTHS A WOMAN MUST WORK TO EARN WHAT A MAN EARNED IN 2018 (MEASURED USING A "MEDIAN PAY" COMPARISON)

[1] *See* Payscale, The State of the Gender Pay Gap 2019.
[2] *Id.*
[3] *Id.*

The "Equal Pay" Gap

Since 2015, more than 60 companies have received shareholder proposals on their gender pay gap. Although initially focused on the tech sector, more recent proxy seasons have seen a proliferation of these proposals in the financial services and retail sectors and, in 2019, in the healthcare sector. The companies targeted by these proposals were some of the largest public companies in the world, which has significantly elevated the prominence of the issue. Prior to the 2019 proxy season, these proposals demanded disclosure of the "equal pay" gap, i.e., the disparity in pay between men and women with comparable jobs and qualifications, as adjusted for factors such as geography and seniority. In 2018, of the 33 proposals that were filed, 24 were withdrawn as companies agreed to make disclosures and work to close their pay gaps.[4]

The Top 100 Companies that disclose in their proxy their "equal pay" gap

11

On average, these disclosures show that women earn 99% of what their male counterparts earn.

2019: The "Median Pay" Gap

While the recent disclosures on the equal pay gap is a welcomed development, these disclosures do not provide information as to the opportunity gap or the representation of women in the most high-paying positions. As a result, in 2019, Arjuna Capital, which has led the fight for gender pay gap disclosures, targeted 12 companies across the banking, tech and retail sectors with a "median pay gap" proposal. The proposal would require the issuer to disclose the median pay of women working full time to that of men working full time. The disclosure of a "median pay" gap is not new to companies that operate in the United Kingdom. Under regulations that became effective in 2017, organizations with over 250 employees doing business in the United Kingdom are required to publish annually their median gender pay gap on a government website.

Of the 12 companies targeted by Arjuna Capital, only Citigroup disclosed its median pay number, which resulted in Arjuna withdrawing its shareholder proposal and Citigroup being the only company to earn an "A" on a Gender Pay Scorecard issued by Arjuna Capital and Proxy Impact. Along with its voluntary disclosure, Citigroup discussed its efforts to reduce the disparity in pay, including increasing representation at the Assistant Vice President through Managing Director levels to at least 40% for women by the end of 2021. (Citigroup also disclosed the median pay for U.S.-based non-majority employees and discussed its efforts to increase representation at the Assistant Vice President through Managing Director levels to at least 8% for black employees in the U.S. by the end of 2021.) Arjuna Capital's shareholder proposal failed at the other 11 companies it targeted, but the pressure on issuers to close the gender pay gap is not going to fade.

14 OF THE TOP 100 COMPANIES RECEIVED SHAREHOLDER PROPOSALS RELATED TO THE GENDER PAY GAP.

ON AVERAGE, THESE PROPOSALS RECEIVED 25.6% SUPPORT. THE SEVEN "MEDIAN PAY GAP" PROPOSALS THAT WERE PUT TO SHAREHOLDER VOTE RECEIVED AN AVERAGE OF 21.5% SUPPORT.

[4] *See* Arjuna Capital and Proxy Impact, Gender Pay Scorecard, Second Edition.

GOVERNMENT ACTIONS

Issues of pay equity are not being left to private ordering alone. Governments, at all levels, and courts are addressing the issue, too.

EEOC

On April 25, 2019, the U.S. District Court for the District of Columbia ordered the Equal Employment Opportunity Commission to comply with an Obama administration rule requiring the collection of pay data, broken down by race, gender and ethnicity. By September 30, 2019, employers with at least 100 employees must report to the EEOC wage information and total hours worked for all employees by race, ethnicity and gender.

Proposed Federal Legislation

In Congress, the Paycheck Fairness Act, first introduced in 1997, was passed by the House of Representatives in March 2019. The bill would, among other things, prohibit employers from using salary history as a way to set salaries for job candidates and from retaliating against workers who discuss their wages. In addition, it would allow workers to sue for punitive damages for wage discrimination.

State Laws

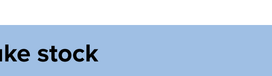
On July 10, 2019, New York became the latest state to strengthen its equal pay legislation, expanding its protections from gender-based discrimination in pay practices to discrimination against additional protected classes, including, among other classes, age, race, creed, sexual orientation and gender identity or expression. In addition, on the same date, New York became the most recent state to forbid employers from asking prospective employees about their salary history, or from relying on salary history to determine wages for any individual.

Litigation

Prior to the start of the 2019 FIFA Women's World Cup, the U.S. Women's World Cup team filed a class action suit against the United States Soccer Federation (USSF) for violations of the Equal Pay Act and Title VII of the Civil Rights Act of 1964, because the USSF pays the women's team substantially less than their male counterparts. The case is far from the only gender pay lawsuit working its way through the courts. In 2018 and 2019, high-profile gender pay class action lawsuits were filed against a number of companies, including Nike, Disney, Oracle and Google.

WHAT CAN COMPANIES DO NOW?

The following is a list of action items for companies concerned about pay inequality within their organization.



Take stock

Companies should consider conducting a comprehensive pay audit that examines pay practices at every level in the organization, and make adjustments to practices that perpetuate pay differences.

Set goals

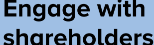
Establish goals for gender representation at senior levels throughout your organization and track your progress against your goals.

Hold managers and directors accountable

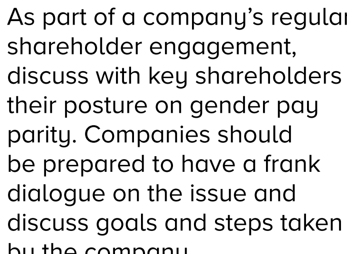
Ensure those making hiring and promotion decisions are held accountable for making progress towards gender equality in the organization. Recently, Uber announced it would be linking incentive compensation to the achievement of workplace diversity goals as it seeks to increase the percentage of women and other underrepresented groups in managerial roles.

Examine hiring and promotion practices

Companies must train managers to identify unconscious bias in hiring, promotion and compensation decisions. Many factors have been cited as contributing to the lack of promotion of women — including job "segregation," where women are tapped for roles that typically do not lead to career progression, and unintentional penalties imposed following leaves of absence for caregiving. Further, provide female employees with mentoring opportunities that can serve to guide them in their career paths.



Engage with shareholders



As part of a company's regular shareholder engagement, discuss with key shareholders their posture on gender pay parity. Companies should be prepared to have a frank dialogue on the issue and discuss goals and steps taken by the company.

INSIGHTS

Lona Nallengara and
Mark A. Dunham, Jr.

TURNING UP THE VOLUME OF BOARD DIVERSITY

The corporate governance debate among companies, institutional investors and advocacy groups has taken a shift over the last few proxy seasons. There are new entrants in the field and the discussions have moved beyond disclosures in the proxy statement and shareholder proposals. Legislators, on a national and state level, employees and customers are now weighing in on how companies select their leaders, manage themselves and engage with the communities around them. There has also been less of a focus on what may have been considered "procedural" governance issues, such as proxy access and special meeting thresholds, due to a growing number of environmental and social issues that have begun to take center stage in the debate. Chief among these issues is board diversity.

Driven by an increased level of external pressure for companies to acknowledge the need to make changes to the "face" of their boards, board diversity continues to feature centrally in internal corporate strategy discussions, investor activism and, most recently, political discourse. The tenor of the conversation on board diversity experienced a notable crescendo in 2017 with the second iteration of the New York City Comptroller's Boardroom Accountability Project, which demanded more than 140 companies to enhance disclosure and engagement on board diversity, and the launch of State Street Global Advisors' "Fearless Girl" campaign, which included a commitment by State Street to engage on diversity with the companies in which it invests.[1] In 2018, BlackRock CEO Larry Fink's annual letter to CEOs signaled the firm's intent to engage companies on having diverse boards, stating that: "Boards with a diverse mix of genders, ethnicities, career experiences, and ways of thinking have, as a result, a more diverse and aware mindset. They are less likely to succumb to groupthink or miss new threats to a company's business model. And they are better able to identify opportunities that promote long-term growth."[2] This commitment was reiterated in his 2019 letter to CEOs.

Legislators are also trying to influence the debate and direct the action taken by companies. In September 2018, the State of California enacted legislation establishing boardroom gender quotas for California-headquartered companies. State legislators in Illinois, Maryland, Massachusetts, New Jersey and Washington are following suit. Putting aside the constitutionality questions, California's action can be seen as an attempt to accelerate what is perceived to be an agonizingly slow road to board diversity.

The debate is no longer limited to whether board diversity is good and how it can strengthen board decision-making. It is now focused on how companies are supporting the development of diverse board talent, how are they changing their director recruitment practices and when there will be meaningful change in board composition.

[1] *See generally* Office of New York City Comptroller, Boardroom Accountability Project 2.0.
[2] *See* Laurence D. Fink, Annual Letter to CEOs, "A Sense of Purpose" (January 2018).

THE NUMBERS

How far has the needle moved in the past year? The data presents incremental, but positive, momentum in many areas.

For the Top 100 Companies, women make up 28% of all directors. For S&P 500 boards, women make up 27% of all directors, representing a 56% increase over the past 11 years.[3] Of the 428 new directors appointed in 2018, women and minorities represented half of the class, with women representing 40%. There is also strength in numbers — in 2018, 87% of S&P 500 boards had two or more women directors, which is up from 22% in 2017. In addition, the number of S&P 500 ethnic minorities appointed to new directorships rose from 18.8% in 2018 to 21.1% in 2019.[4]

More women now lead in key committees, too. Women chair 24% of S&P 500 nominating and governance committees and 20% of audit committees.

When we expand the aperture beyond the S&P 500, however, we do not see comparable levels of representation. For the Russell 3000 companies, the percentage of women serving as directors rose slightly from 18.4% in 2018 to 19% in 2019.

Although, in July 2019, the only remaining all-male board among the S&P 500 appointed a woman, there are still 457 Russell 3000 companies with all-male boards.

Women only represent 7% of independent board chairs.

The number of ethnic minorities appointed to new Russell 3000 directorships fell from 14% in 2018 to 13.3% in 2019. Further adding to the slow pace of change in the number of ethnic minorities is the indicator that, among board members whose race was identified, non-white Russell 3000 directors crossed the 10% threshold for the first time in 2019, compared to approximately eight percent in 2008 — a growth of two percent in 11 years.

Although we are seeing year-over-year increases in representation and boards and are articulating the right message about the efforts they must take, for the most part, many commenters have said change is not happening fast enough. Some have taken the year-over-year increases in diverse representation on boards to extrapolate as to when, for example, gender parity in the boardroom will be achieved. These dates, which are way out on the horizon, have frustrated many advocating for the change to happen sooner.

ASSESSING THE INFLUENCERS

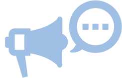
Increasing board diversity requires an assessment of the company's diversity strategy, adjusting board recruitment methodologies and consideration of how to thoughtfully engage with key shareholders and other stakeholders on the progress that is being made.

Shifting Definitions of Diversity

We are all familiar with the SEC disclosure requirements related to board diversity under Item 407 of Regulation S-K that were adopted in 2009. Item 407 requires that a company's proxy statement disclose whether diversity is considered in evaluating candidates for the board and whether the company has a diversity policy. When the SEC adopted the rule, it chose not to define "diversity," which has allowed companies to use their own definition. For many, that meant not specifically identifying gender, race, ethnicity or sexual orientation, but focusing on broader things like perspective, background and thought. The SEC's approach was deferential and broad, recognizing "any differences in the manner in which the nominating committee evaluates nominees for director."[5] Advocates from the start and investors more recently have all but rejected the lack of specificity that the SEC rule provides. For many advocates, it is clear that general notions like diversity of perspective will no longer be enough to meet their expectations for what a board should be looking for.

[3] *See* 2018 United States Spencer Stuart Board Index.
[4] *See* Institutional Shareholder Services, U.S. Board Diversity Trends in 2019 (May 31, 2019).
[5] Regulation S-K, 17 C.F.R. 229.407(vi).

Investor Pressure and Shareholder "Activism"



Institutional investors declaring their support for more board diversity have quickly shifted to making more concrete demands, including numerical expectations and even quotas. As part of its Fearless Girl campaign, State Street announced the aggregate numbers of directors and nominating committee chairs it has voted against in light of failures by these companies to add women to their boards.

State Street's 2019 guidelines state an expectation that boards have at least one female director. BlackRock expects companies to have two. Both also want clear criteria for a director to be considered diverse, like ethnicity and gender. More importantly, institutional investors focused on this issue want to have a meaningful dialogue with companies to learn how they are thinking about and approaching the challenges of building a more diverse board. State Street and BlackRock have both tied their voting decisions, in part, to whether or not a company has engaged with them on board diversity. State Street's 2020 guidance states that failure to have one woman on the board and engage with them on diversity may result in a vote against the entire nominating committee.

Proxy advisory firms are also significant influencers of change. Although Glass Lewis and ISS may have ceded the driver's seat on this issue to institutional investors, both want to see more female directors and their stated policies indicate that they would consider voting against a nominating committee where women are not present on the board.

Finally, advocates are also submitting shareholder proposals to pressure boards to adopt policies regarding director recruitment and selection that are designed to develop a more diverse board. Companies faced with such shareholder proposals are faced with a difficult dilemma when they cannot negotiate a compromise to have the proposal withdrawn — do we try to exclude the proposal by arguing the company already adequately considers diversity, do we recommend voting against the proposal or do we just go along? For many companies, doing anything other than the third option may be untenable from the public and investor relations perspective.

Legislative Actions

State and federal legislators have also been focused on board diversity. California's board diversity law requires companies headquartered in California with shares listed on a major U.S. stock exchange to have at least one female director by the end of 2019, and by the end of 2021, boards with five directors are required to have two female directors and boards with six or more directors must have three.[6] Failure to comply with the law could result in fines. According to a 2018 study of the companies headquartered in California that were in the Russell 3000 Index, based on board composition as of September 2018, 377 companies will have to add female directors to their boards in order to be in compliance with the new law.[7] The law has been, and is expected to continue to be, challenged on constitutional and state law grounds, including under equal protection or internal affairs doctrine analyses.

While the California board diversity law is the only binding statute requiring board gender diversity, other states have focused on the issue prior to, and following, the law's enactment, and a few states have passed non-binding resolutions. Currently, New Jersey and Massachusetts are considering legislation similar to California's in scope. Although not yet in force, in June 2019, Illinois passed legislation which mandates that publicly traded companies in Illinois report on their websites the demographics of their board and executive ranks, as well as plans for promoting diversity in the workplace.

The U.S. Congress has also been active in this area. In July 2019, the House of Representatives' financial services committee passed two bills that would require that the SEC implement rules that would require all public companies to disclose diversity data in their proxy statements. Although this is a long way from mandating quotas (and these bills are also a long way from becoming law), focus on this issue from Congress could increase the volume of the debate.

[6] *See* California Senate Bill No. 826; *see also* H.R. 1016, "Improving Corporate Governance Through Diversity Act of 2019" (February 9, 2019).
[7] *See* Annalisa Barrett, "How Many California Companies Have To Add Women To Their Boards" (October 1, 2018).

WHERE IS THE BOARD DIVERSITY DEBATE GOING?

As with many governance issues that have arisen in the last decade, legislative and regulatory responses will not be the only force moving the needle on board diversity. While there will continue to be calls for the SEC to require more enhanced disclosure related to board diversity and board practices related to the identification and selection of directors, it is unlikely that the SEC will respond with rulemaking. Frankly, most would agree that the securities laws are not the place for mandating who should be in the boardroom.

Private ordering will likely be the real accelerant for change in board composition. These private ordering activities include the following:

Specific and concrete expectations from institutional shareholders, with targets and deadlines

Shareholder proposals that require companies to adopt policies and state goals related to board diversity

Grassroots activism by employees and customers demanding a more representative board from the companies at which they work or from the companies with which they engage

WHAT SHOULD BOARDS DO NOW?

1 **Know your numbers.** Benchmark your board diversity metrics against your peer group, your broader industry and public trends more generally.

Engage with your significant investors. Increasingly, institutional investors want to hear from companies on board diversity, and some will condition support for directors on a meaningful dialogue on diversity. These conversations do not have to be led by the chair of the nominating committee, as long as the company's representative can credibly address the key issues. The input received from these discussions should be shared with the board and be taken into consideration as the board refines and further develops its own policy.

Talk about your policy regarding board diversity. Directors should have a discussion on what its perspective is or should be regarding board diversity. The board should talk about how it defines diversity, how diversity impacts director selection attributes and how director recruitment practices may need to be changed. As part of this discussion, the board should consider expectations from all stakeholders and what the board wants to say publicly about diversity. The board should also be prepared to have the difficult conversation of board refreshment and how the composition and tenure of the current board will enhance or impede diversity efforts. Finally, the board should consider setting goals and targets for itself.

4 **Clarify your director nomination criteria.** Ensure that the company's specific experience, qualifications, attributes and skills reflect the board's policy and definition of diversity. This may include making specific reference to race, gender, ethnicity, nationality, sexual orientation or cultural background as factors that the board considers in its selection process.

5 **Review and refresh your director candidate recruitment procedures.** Implement director candidate recruitment practices that are in line with the board's policy. This could mean using additional or new search firms that will assist in identifying diverse candidates, seeking recommendations for possible candidates from outside the existing board and even requiring the consideration of at least one diverse candidate for each vacancy.

6 **Tell your story.** Use the proxy statement to describe the company's policy and perspective on board diversity. Ensure that it is plainly and clearly presented. Process matters, too — if the company has a good story to tell regarding its policies on candidate identification, include it as part of the discussion.

Tie it together. Make sure the company's corporate governance guidelines and committee charters reflect the board's thinking on diversity.

INSIGHTS

Lona Nallengara and
Emma Maconick

CYBERSECURITY – PREPARING FOR THE CHANGING LANDSCAPE

Topics like corporate culture, board diversity and sustainability continue to dominate the discussions among directors and those that advise them. These issues are also drawing the attention of institutional investors and, more recently, employees and customers are adding themselves to the debate. While these issues are taking up even more space on the shareholder engagement calendar of public companies and the "ordinary" governance issues, such as CEO/board chair separation or majority voting, are receiving less attention than in the past, risk management continues to be an important priority on the board agenda. For most companies, cybersecurity and data protection are chief among these risk management issues.

The changes to the cybersecurity and data protection landscape have been significant. The growing number and sophistication of cyberattacks, the involvement of state actors and cyber-activists and the growing acceptance of the fact that no industry or company is immune compels directors to ensure preparedness and responsiveness do not fall off the board agenda or end up relegated to quarterly briefings by the chief information security officer or the head of information technology.

WHAT SHOULD BOARDS BE THINKING ABOUT NOW?

Cybersecurity and data protection are not new areas of focus for directors. Most general counsels and corporate secretaries are working with their board chairs to make more time on the crowded board agenda to discuss these issues. Whether the goal is to better understand the company's risk profile, assess management's handling of cybersecurity threats or learn about emerging trends and best practices, directors are becoming educated on these issues, and the recent developments discussed below should be part of those discussions.

GDPR and the Increasing Importance of Data Security and Privacy

In May 2018, the General Data Protection Regulation (GDPR) took effect in the European Union. The GDPR's reach is broad, affecting all companies operating in the European Union and those companies collecting personally identifiable information from people residing in the European Union. Not only does the GDPR require that companies implement certain information protection protocols and appoint a senior officer responsible for data protection, the GDPR also establishes a 72-hour cybersecurity breach notification framework. Failure to comply with the ongoing and incident response requirements of the GDPR can result in significant monetary sanctions.

Through the experience with the GDPR and the growing scrutiny over how social media companies in the United States are collecting, storing and monetizing personal data they collect, calls have grown louder for similar protective legislation in the United States. Legislators, advocates and consumers are seeking national-level regulations that address the information that companies collect from consumers, including who owns it, what control consumers have over it once they share it and what responsibilities companies have to safeguard that information. In the absence of federal action, in 2018, California enacted the California Consumer Privacy Act, which some have called a precursor to a U.S. version of GDPR legislation. The California legislation is narrower in scope than the GDPR, as it does not address information protection requirements, or cross-border data transfers. It does, however, represent a first step into a more comprehensive data privacy and information security regulatory framework in the United States.

Most directors are already aware of the critical importance of protecting personal data and customer information. The headlines of companies reporting theft of personally identifiable information due to a vulnerability in information security have become the norm. Directors should focus on the information that their companies collect from their customers, how that information is used and how much transparency the company provides to consumers regarding the use of the information. Given the microscope placed on social media companies and other information collectors, both consumers and regulators are intensely focused on privacy issues. As a result, the oversight of how a company handles these functions is becoming increasingly important for the board.

Cybersecurity is a Financial Reporting Matter

In October 2018, the SEC issued a report related to an investigation that it had conducted on nine companies that were victims of cybersecurity fraud.[1] The incidents that were the subject of the report were single-event business email compromises, and not headline-grabbing cybersecurity incidents where personal data of millions of customers is released on the dark web or ransomware attacks that shut down large public companies or metropolitan cities. The report focused on the intersection of financial reporting and cybersecurity, and made it clear that the SEC wants to make "issuers and other market participants aware that cybersecurity risks should be considered when devising and maintaining a system of internal accounting controls as required by the federal securities laws." More specifically, the report stated that "all public companies have obligations to maintain sufficient internal accounting controls and should consider cyber threats when fulfilling those obligations." The SEC's position, as stated in this report, clearly reinforces the view that cybersecurity is an enterprise-wide risk management issue, but it also adds a new layer of attention.

Although the nine cases described in the report did not result in enforcement actions, the report is a warning to boards and management of public companies that the integrity of the financial reporting infrastructure will be another area of focus if and when the SEC calls following a cybersecurity event. Not only can a cybersecurity incident result in remediation costs, loss of business and reputational damage, but a company buffeting the storms of a cybersecurity event may also face an SEC enforcement investigation related to a failure to have adequate internal controls.

[1] *See* SEC, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding Certain Cyber-Related Frauds Perpetrated Against Public Companies and Related Internal Accounting Controls Requirements (SEC Release No. 84429) (October 16, 2018).

Government Regulation and Oversight: It is Only Getting Started

Late in 2018, the President formed the Cybersecurity and Infrastructure Security Agency (CISA), a new federal agency within the Department of Homeland Security, which is focused on coordination of cybersecurity across all levels of government, and is charged with enhancing the security and resilience of United States cybersecurity, emergency communications and critical infrastructure. CISA's attention has been directed toward critical infrastructure, global technology supply chain and election security and integrity, which demonstrates a recognition of the need for centralized coordination of these issues within government, the need for specialized expertise and knowledge and the importance of a dedicated focus on cybersecurity issues on a continuous basis.

Interestingly, these are all concepts that companies and their boards of directors should be considering as they develop their own cybersecurity and data protection strategies. The federal government's focus on cybersecurity may provide the impetus for direct engagement with public companies to better understand vulnerabilities, preparedness and responsiveness and to introduce a more robust regulatory framework to protect personal information.

Across the United States, consumer protection statutes already in effect require companies to take certain steps when consumer data or personal information is compromised. When personal information is not the subject of a cybersecurity incident, however, companies may search for someone to notify. Currently, companies that are not regulated by a federal or state department or agency have no defined "place" to report a cybersecurity incident. For many public companies, their only "regulator" is the SEC, and the SEC is not really equipped, nor does it have the mandate, to receive general reports of cybersecurity events. Companies may also turn to the local Federal Bureau of Investigation (FBI) office, often with unsatisfying results due to the sheer number of notifications received and the lack of resources deployed. It is possible that CISA could establish a more organized way to notify and share information regarding cybersecurity incidents and threats to enable a governmental body to monitor threats and incidents to identify patterns, risks and culprits.

In addition, Congress — both the House of Representatives and the Senate — are also getting involved. Congress has actively considered legislation across a range of topics related to public company oversight of cybersecurity matters. One recent bill gaining traction in Congress, and of particular interest to public companies, would establish a new disclosure rule requiring public companies to disclose whether or not the board has a director who qualifies as a cybersecurity expert and, if there is no such director, the company's cybersecurity measures that render such a cybersecurity expert unnecessary.

To be clear, this legislation does not mandate any action with respect to changing the composition of the board. Congress understands that such demands often face challenges. On its face, it is a disclosure requirement that demands companies disclose and explain their decision-making related to the current composition of the board. The "explain" part, however, will force boards to think carefully before affirmatively stating that the company does not need a cybersecurity expert on the board, particularly when peer companies are taking a different approach.

While this legislation is a long way from becoming a proxy statement disclosure requirement, it highlights that Congress is pressing public companies to think critically about how cybersecurity risks are managed and who is responsible for them. These actions may also fuel discussions with institutional investors and others in ordinary course engagement efforts. As nominating committee chairs engage with investors about board composition and refreshment, questions will inevitably be raised as to whether cybersecurity expertise should be a skill set necessary for the board.

WHAT SHOULD BOARDS DO NOW?

Understand Your Company's Risks, Policies and Legal Requirements

Directors should understand the types of cybersecurity risks that their company faces. They should be briefed on relevant threats and vulnerabilities and engage in discussions about how the company prioritizes these threats and vulnerabilities. Some companies will determine that a level of acceptable risk is part of running their business in the ordinary course. In these cases, the board should understand how this assessment was performed, what factors were considered by management and the best practices for similarly situated companies. For companies that collect and manage consumer information, the board should understand and regularly review the policies and practices related to disclosures made to consumers when information is collected, such as how the company stores and uses consumer information and whether the company's practices comply with current regulatory requirements and industry practices. Irreparable reputational damage can result if a company fails to protect, or is perceived as failing to protect, consumer information with the rigor expected by the individual subjects of that information.

Centralize and Organize

Directors have all heard that cybersecurity matters must be treated as an enterprise risk management issue, but what does that mean? Simply stated, it means that no single part of the business should have sole responsibility for managing and addressing risks. Instead, management should ensure that cybersecurity and data protection risks are both viewed and addressed as a shared responsibility among appropriate groups within a company and not relegated to an information security function. The "appropriate groups" may differ from company to company, but it should always include, at a minimum, those responsible for technology and information security, disclosure, legal and regulatory compliance and financial reporting, including SEC reporting. The board, in turn, is responsible for ensuring that management has a plan to address these issues on a company-wide basis, is devoting the proper resources to the plan and has hired the people with the experience and expertise to execute the plan effectively. There is no single solution that works for all companies. For some, it may require a dedicated committee and/or one or more directors with specific and identifiable experience. Others may need regular briefings and third-party experts to provide ad hoc advice and testing. At the end of the day, whether or not there is an SEC disclosure requirement concerning director cybersecurity expertise, boards must be able to assess how well management is handling the risks, and to describe the board's role in the oversight of cybersecurity and data protection matters.

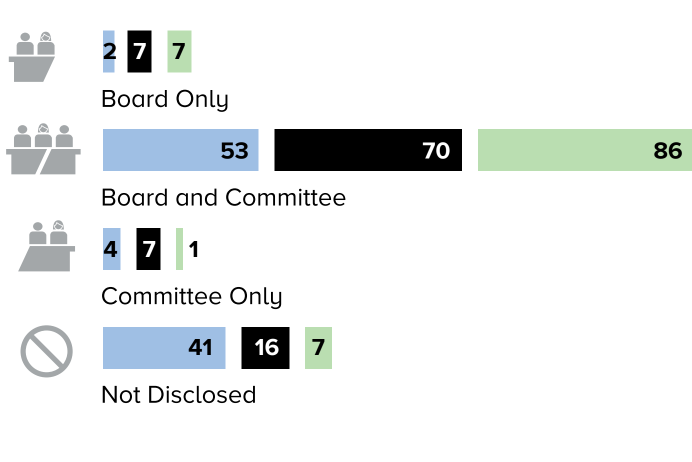
Third Parties are Important, Too

Oversight of cybersecurity risk on an enterprise-wide level includes understanding threats to a company's critical operations that are not directly under the company's control. Many companies have outsourced or contracted critical technology and non-technology functions to third parties. Understanding the possible cybersecurity threats to which these third parties are exposed and the vulnerability of the data that may be provided to third parties is an important part of the board's oversight — these should also be considered threats to and vulnerabilities of the company. The board should ensure that management has assessed the cybersecurity preparedness and responsiveness of critical partners and vendors, and formulated plans to ensure that replacement products or services are readily available in the event of an incident.

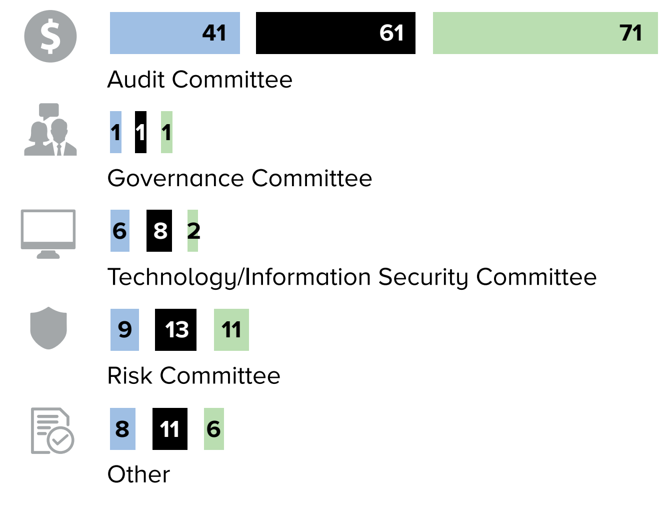
	2017	2018	2019
RESPONSIBILITY FOR CYBERSECURITY MATTERS The number of Top 100 Companies that indicated that the board and/or a board committee had responsibility for cybersecurity matters:	59	84	94
DIRECTORS WITH CYBERSECURITY EXPERIENCE The number of Top 100 Companies that specifically identified directors with cybersecurity or data security experience:	29	35	36
CYBERSECURITY RISK MANAGEMENT The number of Top 100 Companies that identified cybersecurity as part of the board's oversight role over risk management:	58	85	87

AT THE TOP 100 COMPANIES:

Who has responsibility for cybersecurity and/or data security/privacy?



If a committee is involved, which committee?*



2017 2018 2019

* For several companies, responsibility for cybersecurity and/or data security/privacy is shared by two or more committees.

INSIGHTS

Doreen E. Lilienfeld and
Maxmilien R. Bradley

HUMAN CAPITAL MANAGEMENT DISCLOSURE

Current law does not require much from a public company in the way of disclosing information concerning its workforce (its "human capital") outside the C-suite or with respect to the philosophies, policies and practices it implements to select, oversee, nurture and develop that workforce (its system of "human capital management"). Under SEC disclosure requirements (Item 101 of Regulation S-K) a public company need disclose no more than its total number of employees, and common practice is to do no more than that. Recently, though, a growing number of stakeholders — special interest groups, investors, the SEC and public companies themselves — have questioned and publicly discussed whether human capital management disclosure requirements should be expanded or, if not, whether a public company should voluntarily disclose its approach to ensuring that its human capital is diverse, developing, motivated and positioned to contribute to the long-term value of the company. To that end, the SEC, on August 8, 2019, issued proposed amendments to Item 101 of Regulation S-K that would require principles-based disclosure of matters related to human capital.

This article surveys the current landscape and provides recommendations to public companies considering how to approach disclosure in this increasingly important area.

A CALL FOR ENHANCED DISCLOSURE

On March 28, 2019, the Investor Advisory Committee (IAC) to the SEC recommended that the SEC recognize the significance of human capital management and "incorporate it as a part of the Commission's Disclosure Effectiveness Review and the Commission's approach to modernizing corporate reporting and disclosure."[1] As explained in the written recommendation, the U.S. economy has transitioned from one based on industrial production and tangible assets to one based on intangible assets and human services, and the current disclosure rules — based on the antiquated view that human capital is a cost rather than a driver of financial performance — have failed to respond. Since, in the view of the IAC, human capital is the "primary source of value" of many of the most dynamic U.S. companies, it encouraged the SEC to engage with investors, issuers and the academic community in an effort to improve and augment existing human capital management disclosure.

SEC Chairman Jay Clayton seems interested. In remarks published in connection with the IAC recommendation, Chairman Clayton

[1] *See* Recommendation of the SEC Investor Advisory Committee, Human Capital Management Disclosure (March 28, 2019). The Disclosure Effectiveness Review is a project undertaken by the SEC's Division of Corporation Finance to review and modernize the form and content of public company reporting.

referred to human capital as, for some companies, a "mission-critical asset," explaining that "the historical approach of disclosing only the costs of compensation and benefits often is not enough to fully understand the value and impact of human capital on the performance and future prospects of an organization."[2] In light of this potential inadequacy of the current disclosure rules, Chairman Clayton expressed the view that investors might be better served by a principles-based (rather than a rules-based) disclosure framework that would allow them to understand "the lens through which each company looks at its human capital."

The recommendation of the IAC and the remarks of Chairman Clayton were not made in a vacuum; instead, they followed a sustained series of calls for enhanced human capital management disclosure from special interest groups and investors. On July 6, 2017, the Human Capital Management Coalition (HCMC), a cooperative effort of 26 institutional investors representing over $3 trillion in assets, petitioned the SEC for rulemaking seeking more disclosure.[3] Citing a litany of empirical research and academic work that, in its view, shows that "thoughtful management of human capital is associated with better corporate performance, including risk mitigation," and highlighting the current lack of, and investor demand for, fulsome disclosure of public company human capital data, the HCMC urged the SEC to consider rules requiring human capital disclosures from public companies on workforce demographics, turnover, diversity, culture, and health and safety. The HCMC, in a March 22, 2019 letter to the IAC, reaffirmed its support for the adoption of human capital management disclosure rules; indeed, the IAC included the petition of the HCMC (and the fact that the HCMC represents a number of large institutional investors) as a finding in support of its recommendation to the SEC.[4]

BlackRock, the world's largest asset manager, has made a similar call. In 2019, BlackRock, as it had in 2018, identified human capital management as one of its five engagement priorities (along with governance, corporate strategy and capital allocation, compensation that promotes long-termism and environmental risks and opportunities),[5] explaining that human capital management is a critical investment issue and "it is therefore important to investors that companies explain as part of their corporate strategy how they establish themselves as the employer of choice for the workers on whom they depend."[6]

Finally, the Embankment Project for Inclusive Capitalism (EPIC), a project intended "to identify and create new metrics to measure and demonstrate long-term value to financial markets" by the Coalition for Inclusive Capitalism and Ernst & Young, participated in by more than 30 asset owners (such as Allstate, CalPERS and MetLife), asset managers (like Vanguard, State Street and Fidelity) and companies (three of which are in the Top 100 Companies)[7] and claiming to represent more than $30 trillion of assets under management, joined the same call.[8] In its 2018 report, EPIC identified "talent" as one of the four key "factors that define long-term value" for which company disclosure of consistent and comparable metrics are most needed (along with innovation and consumer trends, society and the environment, and corporate governance). According to the report, EPIC participants concurred that employees play a key role in "a company's ability to create long-term value" and therefore developed and proposed a series of metrics to allow investors to measure a company's management of its "talent" in the areas of human capital deployment, organizational culture and employee health.

The SEC has begun to respond. On August 8, 2019, it announced proposed amendments to Regulation S-K that include requiring a "description of the registrant's human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel)."[9] In proposing this principles-based disclosure requirement, the SEC noted that "human capital measures or objectives" that are material to one company may be immaterial to another and may vary over time and by industry.

[2] *See* Chairman Jay Clayton, Remarks to the SEC Investor Advisory Committee (March 28, 2019).

[3] *See* Letter to William Hinman, Director, SEC Division of Corporation Finance, from the Human Capital Management Coalition (July 6, 2017).

[4] *See* Letter to Anne Sheehan, Chair, SEC Investor Advisory Committee, from the Human Capital Management Coalition (March 22, 2019); Investor Advisory Committee, *supra* note 1.

[5] *See* BlackRock Investment Stewardship Engagement Priorities for 2019 (January 2019).

[6] *See* BlackRock Investment Stewardship's Approach to Engagement on Human Capital Management (January 2019).

[7] DowDuPont, Johnson & Johnson and PepsiCo.

[8] *See* Embankment Project for Inclusive Capitalism.

[9] Modernization of Regulation S-K, Items 101, 103 and 105, SEC Release No. 10668 (August 8, 2019).

WHAT DO STAKEHOLDERS WANT TO KNOW?

While a growing number of stakeholders are joining the call for enhanced human capital management disclosure, a clear picture of what those stakeholders would like to see disclosed has yet to emerge. Some key points these stakeholders have raised in their calls for enhanced human capital management disclosure are summarized below.

KEY POINTS

A proposed revision of Item 101(c) of Regulation S-K requiring a principles-based "description of the registrant's human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel)."[10]

Stakeholder Suggested Workforce Disclosures:[11]

- Demographics (number of full-time, part-time, contingent, subcontracted and outsourced workers)
- Stability (turnover, internal hire rate)
- Composition (diversity, pay equity)
- Skills and capabilities (training, alignment with business strategy, skill gaps)
- Culture and empowerment (engagement, union representation, work-life initiatives)
- Health and safety (injuries, fatalities, lost day rate)
- Productivity (return on cost of workforce, profit/revenue per full-time employee)
- Compensation and incentives (bonus metrics, measures to counterbalance risks created by incentives)

While engaging with boards on human capital management issues, stakeholders like BlackRock want to hear about:[12]

- Oversight of policies meant to protect employees, like whistleblowing, codes of conduct and EEO policies, and the reporting structures the board relies on to assess their implementation
- How the human capital management structure ensures a healthy culture and prevents unwanted behaviors
- Board and employee diversity data
- Consideration of linking human capital management performance to executive compensation
- Reporting to the board on the integration of human capital management risks into risk management processes
- Board member visits to workplaces to assess the culture and operations of the company

[10] *See* SEC, *supra* note 9.
[11] *See* HCMC, *supra* note 3.
[12] *See* BlackRock, *supra* note 6.

THREE STEPS TO DEVELOPING A HUMAN CAPITAL MANAGEMENT (AND DISCLOSURE) APPROACH

In approaching human capital management (and related disclosure), we suggest public companies consider the following three steps.

1

"Understand the lens" (in the words of SEC Chairman Jay Clayton) through which the company looks at human capital.[13] Not only, as Chairman Clayton pointed out, should any human capital management *disclosure* approach apply the "lens" through which the company looks at human capital, the company's human capital management approach *itself* should begin with a clear understanding of that "lens." Each company's "lens" requires individualized crafting as the contours will vary from company to company and in different industries and geographies. Companies must consider such questions as, is human capital among the primary concerns of the company, or is it an ancillary one? How does the company approach human capital — as an independent item to be focused on, or is it integrated into discussion of the larger picture (for instance, culture, or long-termism, or risk)? What aspects of human capital — diversity, training, turnover — matter most to the company?

2

Construct an aligned human capital management strategy. This buildout will initially depend on identifying the groups that are responsible for its construction. Senior management and the board should be key among those groups. Management's role in developing human capital should be clearly defined by identifying who in management will be responsible for the strategy. Should the CEO be reimagined as a "Chief Talent Officer"? Should the Chief Human Resources Officer be elevated to a strategic management role?[14] As with culture, it is important to add human capital management to the board agenda; as BlackRock noted in its human capital management engagement commentary document, "HCM is both a board and a management issue."[15] From here, a company should determine whether adding human capital management oversight as a core responsibility of a selected committee aligns with its "lens;" some of the Top 100 Companies have done just that.[16] Doing so will not only result in a board that is better able to develop human capital and manage human capital risk, but will also signal to stakeholders that effective human capital management is an issue the board is fully engaged on.

3

Determine if, and what, to disclose. Even a company that follows steps 1 and 2 is under no current obligation to disclose it. Determining if, and what, to disclose is a company-by-company consideration. For any company, though, disclosing the "lens" through which the company looks at human capital, and the basic structures of human capital management that the board and the company have built, will allow the company to proactively, and on its own terms, provide the marketplace with the basic human capital management information that many influential stakeholders have called for.

[13] *See* Chairman Jay Clayton, *supra* note 2.

[14] *See* Ram Charan, Dominic Barton & Dennis Carey, "People Before Strategy: A New Role for the CHRO," Harvard Business Review (July – August 2015).

[15] *See* BlackRock, *supra* note 6.

[16] *See,* e.g., McDonald's (Public Policy & Strategy Committee); Wells Fargo (Human Resources Committee).

INSIGHTS

George A. Casey, Scott D. Petepiece
and Richard C. Fischetti

SHAREHOLDER ACTIVISM TRENDS IN 2019

After a record-breaking year in 2018, shareholder activism slowed in the first quarter of 2019, returning to pre-2018 historic levels.

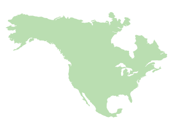
Globally,

295

companies were targeted in public activist campaigns in the first quarter of 2019, representing a 20% decrease against the same period in 2018, which saw the highest quarterly activity on record.

Of those targeted in the first quarter of 2019:

207



companies were headquartered in North America (70%)

21

in Asia (7%)

2

in the Middle East and Africa (1%)[1]

40

in Europe (14%)

25

in Australia (8%)

GLOBAL ACTIVITY LEVELS

While activity levels in the United States decreased compared to the first quarter of 2018, activist activity in Europe continued to be robust in the first quarter of 2019, with activists focusing primarily on advancing their existing campaigns.[2] The United Kingdom had a particularly busy first quarter with 17 companies facing public activist demands, representing a 21% increase from the first quarter of 2018.[3] In Asia, where activism had been gaining traction in recent years, the number of companies targeted in the first quarter of 2019 fell by 38% compared to the record levels during the same period in 2018.[4]

Globally, a total of 57 new activist campaigns were launched against 53 companies as of March 31, 2019, with $11.3 billion of capital deployed (down from $25.3 billion deployed in the first quarter of 2018 and in line with the mean quarterly deployment of $13.1 billion during 2016–2018).[5]

Smaller targets continue to attract activist attention, as the cost of building a significant position from which to influence management and board decisions is lower in smaller-cap companies. For example, in the first quarter of 2019, 34% of all activist demands targeted companies with a market cap below $250 million, and 52% of all activist demands targeted companies with a market cap below $2 billion (compared to 34% and 56%, respectively, during the same period in 2018). Companies with a market cap above $10 billion accounted for 28% of all targets in the first quarter of 2019, similar to the corresponding quarter in 2018.[6]

[1] Shareholder Activism in Q1 2019, Activist Insight ("Activist Insight").

[2] Lazard's Shareholder Advisory Group, Review of Shareholder Activism - Q1 2019 ("Lazard Review").

[3] Activist Insight.

[4] *Id.*

[5] Lazard Review.

[6] Activist Insight.

BOARD REPRESENTATION REMAINS KEY FOCUS

As in 2018, the most common demand made by activists in the first quarter of 2019 across all geographies was board representation. In the United States, all board seats won by activists were secured through settlements, rather than contested votes, reflecting companies' continued reluctance to engage in proxy contests.[7] Notably, "long-slate" nominations, in which activists seek to replace at least 50% of the incumbent board, accounted for more than one-third of all board nomination campaigns in the first quarter of 2019 (compared to 17% of board nomination campaigns in 2018), signaling activists' growing confidence and ambitions when demanding board changes.[8]

Continuing a trend from last year, M&A-driven campaigns, including advocating for companies' sales or industry consolidation, intervening in announced transactions or initiating divestitures, remained on the rise, accounting for 14% of the campaigns launched in the United States in the first quarter of 2019 (compared to 12% during the same period in 2018).[9]

OLD PLAYERS ASSUMING NEW ROLES

The first quarter of 2019 saw traditional active managers increase their engagement in activist situations. Perhaps seeking a way to drive better returns as a response to pressure from clients and increasing competition from passive investment managers, active managers have been becoming more vocal when siding with companies or activists and directly engaging management and other shareholders to promote the managers' independent propositions.[10] It remains to be seen whether this new strategy on the part of active managers signals a shift to a more assertive approach to value-creation in the long term.

FOCUS ON ESG

Continuing a multi-year trend, ESG matters in 2019 have become a focal point for traditional and non-traditional activists alike.

ESG-driven demands by traditional activists have continued to grow in 2019. In the first half of 2019, new activist campaigns in the United States have included 57 ESG-driven demands, well on pace to surpass the record 78 demands made in 2017.[11]

Institutional investors, who have historically maintained a low profile in the activist landscape, have also been increasingly outspoken about the impact of corporate culture and ESG performance on promoting long-term shareholder value. For example, in his public January 2019 "Letter to CEOs: Purpose & Profit," Larry Fink, CEO of BlackRock, called upon companies to become more involved in issues of public importance and demonstrate their commitment to the communities where they operate, thereby fulfilling their corporate purpose and responsibilities towards their stakeholders. Cyrus Taraporevala, President and CEO of State Street, similarly addressed boards in a January 2019 public letter, urging them to concentrate on corporate culture and stressing its importance at critical corporate junctures, such as leadership transitions or strategic mergers and acquisitions.

In addition, activism on ESG matters by passive investors has not only gone mainstream but appears to be yielding results. For example, Climate Action 100+, an investor coalition backed by investors with over $33 trillion in assets under management, has been engaging with companies on climate change issues. In February 2019, Glencore, one of the world's largest coal producers, announced that, following engagement with Climate Action 100+ investors, it was capping its coal production capacity and boosting board review and public disclosure on its climate change performance. In other campaigns, As You Sow, a sustainability-focused investor advocacy group, has been very active in engaging investors to challenge companies on climate change (Chevron, Shell), public health risks (ExxonMobil, DowDuPont, PepsiCo), consumer packaging (Starbucks, Kroger, Yum! Brands) and gender diversity (Skechers, Caesars Entertainment).

The activist landscape is constantly evolving, and as a result, it can present challenges for boards. That being said, ongoing engagement with shareholders and anticipating and understanding potential areas that are of interest to activists remain key strategies that every public company board should be considering. As always, when engaging directly with shareholder activists, directors and senior management should stay focused to ensure that their response is in the best interest of all shareholders.

[7] Lazard Review.
[8] *Id.*
[9] Activist Insight.
[10] Lazard Review.
[11] FactSet.

INSIGHTS

Gillian Emmett Moldowan,
Annie P. Anderson,* Jai Garg and
Arielle L. Katzman

INTERNAL AND EXTERNAL FORCES — THE RISING IMPORTANCE OF CORPORATE CULTURE REVIEW

Corporate boards and executives continuously strive to identify and manage the key drivers of corporate performance. Corporate culture, which until recently was rarely identified as one of these drivers, is now viewed as an essential area to monitor. In particular, in light of a spate of corporate scandals generated by executive misconduct and systemic risk-taking that negatively impacted company performance, pressure has been mounting on boards and management to conduct a closer review of cultural indicators.

Change comes with inherent challenges — culture may define a company's identity, but it is not as tangible or easily quantified as the metrics traditionally used to measure corporate performance. And, because corporate culture is still a relatively new consideration, there is no singular or market method for evaluating "culture." Furthermore, a direct peer comparison, which is a common tool used to determine corporate achievement, is difficult to ascertain in light of limited disclosure on the topic, and even if available, would likely be of little use due to the company-specific nature of what is being measured.

Due to these challenges, companies may still find resistance to placing a corporate culture review on the board agenda. If the rising "activism" of employees calling on their corporate employers to take a stand on certain social issues and the louder voices of institutional investors like BlackRock and State Street have not generated the spark needed to move a company's board toward a consideration of this topic, companies should think about the following: notwithstanding the abstract nature of any company's culture, corporate culture can affect the bottom line.

CULTURE MATTERS

A 2018 study by Ernst & Young shows that intangible corporate assets average 52% of an organization's market value.[1] CEOs and CFOs commonly recognize culture as one of the main forces behind a company's valuation, as an increasing number of economic studies are showing a connection between good corporate culture and higher profitability/returns to shareholders.[2] Transparency of corporate culture is also important as employees and investors seek to hold companies accountable for their behaviors. Negative corporate culture is now associated with dissatisfied employees and poor performance.

ASSESSMENT IS POSSIBLE

Companies can start assessing culture with data that, in many cases, they already have on hand.

In recognizing how corporate culture can ultimately affect corporate performance, boards and executives should take a comprehensive approach to reviewing and understanding their culture so that they can craft the culture they want to disseminate and model through a tone from the top. A comprehensive evaluation requires consideration of how culture is perceived both internally and externally. From an internal standpoint, corporate culture ultimately can impact the bottom line through employee engagement, performance and retention. From an external standpoint, corporate culture influences investor decision-making and business relationships with current and prospective clients.

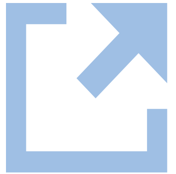
* Pending Admission (New York).

1 *See* Ernst & Young, "Is Everything That Counts Being Counted?" (2018).

2 *See* Andrew Chamberlain et al., "Measuring Culture in Leading Companies," MIT Sloan Management Review (June 24, 2019); *see also* JUST Capital, "The Win-Win of JUST Jobs" (April 2019).

INTERNAL FORCES

Internal perceptions of corporate culture can have measurable impacts on employee engagement, and ultimately, performance and retention. Companies should actively seek to foster a positive and authentic workplace culture in order to achieve sustained success.



Turnover Rates

Companies that suffer from a negative culture, and, in particular, those that suffer reputational damage, frequently lose talented employees. Increased turnover impacts the bottom line by ratcheting up recruiting and training costs. It also creates lost continuity and institutional knowledge. A negative culture can even make it difficult for companies to attract and retain the right leadership, which could ultimately impede a company's short- and long-term development. Conversely, companies can recruit employees that embody particular traits or skills as part of a cultural reformation effort.

Employee Reviews

Employee assessment of culture not only manifests in the day-to-day experience of workers, but is also a predictor of more global and long-term outcomes. A recent study in the *Journal of Financial Economics* found that companies that experienced improvements in their Glassdoor ratings demonstrated better stock market performance than companies that experienced declines in their Glassdoor ratings. The rating categories that most clearly correlated to market performance were "career opportunities" and "perceptions of senior management."[3]

Employee Performance

Companies can face challenges in maximizing the productivity of their workforce if the corporate culture leaves employees feeling unfocused and disconnected. Employees are most productive when they feel happy and inspired at work. By developing clear cultural goals, companies can make their mission more concrete, engaging their employees and enhancing performance.

Customer Satisfaction Surveys

Workplace culture impacts how employees engage with customers. A 2015 study in the *Harvard Business Review* surveyed employees regarding their motivating factors and analyzed the results against customer satisfaction surveys in the airline and grocery industries. The study found that strong workplace cultures (i.e., companies where employees were motivated by the work they were doing and believed the work would lead to future benefits) were predictive of higher customer satisfaction.[4]

[3] *See* T. Clifton Green et al, "Crowdsourced Employer Reviews and Stock Returns," Journal of Financial Economics (March 25, 2019).
[4] *See* Neel Doshi & Lindsay McGregor, "How Company Culture Shapes Employee Motivation," Harvard Business Review (November 25, 2015).

EXTERNAL FORCES

External perceptions of corporate culture can have measurable impacts on investor interest and strategic partner satisfaction, and ultimately, stock price and business performance. Companies should actively seek to engage with investors and strategic partners on cultural touchstones and alignment.

Investor Engagement

Investors increasingly condition their capital on acceptable corporate operations, and culture is now part of that matrix. Who invests in the company and how they engage can be evaluated to assess corporate culture perceptions, which will also be reflected in the outcome of shareholder votes. Companies must be cognizant of the spirit of millennial investing, as well as the evolving priorities of institutional investors;[5] and the frequency of candid discussions of cultural challenges, both in the news and through publicly available disclosure documents, suggests that companies are recognizing this. As companies recognize that investors impute value to culture, we would expect to see increased disclosure of corporate culture by companies, including in the form of risk factors and business descriptions, due to materiality, even if not required by any specific line item.

Strategic Partner Alignment

Third-party companies that interact with companies on both an upstream and downstream basis may take a keen interest in the corporate culture of counterparties. Taking the simple model of a retail business, suppliers and end customers evaluate corporate cultural practices. Manufacturer suppliers may only want to display and market products through reputable retailers. Additionally, customers may resolve to only patronize shops or online stores that embrace particular cultural principles. Companies should assess whether they are getting pushback from existing or potential strategic partners due to cultural misalignment.

Market Examples

Although culture is not the type of metric that can be evaluated through direct peer comparisons, companies often look to peer companies for guidance on cultural development and reference “aspirational” examples in the market. A company should consider whether it is seen as a model (or the opposite) in areas that are typically associated with a positive corporate culture, such as diversity, trustworthiness and transparency. Thus, the market comparison is qualitative, rather than quantitative.

[5] *See* Leslie Albrecht, “This Is What Millennials Care About When They Invest,” MarketWatch (September 11, 2018); *see also* Letter from Cyrus Taraporevala, President and CEO of State Street Global Advisors, to the Board of Directors (January 15, 2019).

SUGGESTIONS FOR REVIEWING CORPORATE CULTURE

Monitoring and measuring the impacts of corporate culture may pose challenges, but in today's governance climate, these challenges do not justify avoidance of the topic. Despite a lack of mandated standards or required reporting, there are actions that boards and executives can take to implement a multidimensional review of corporate culture, considering both internal and external constituencies.

1. Identify what culture means to the company.
2. Coordinate between the board and management to establish a culture-focused action plan that mandates concrete behaviors to help cultivate the desired culture.
3. Utilize culture assessment tools already available from internal and external sources — mine survey data, exit interviews, hotline calls and employee engagement surveys to find themes, both positive and negative.
4. Hire outside consultants to conduct assessments focused on culture reviews and assist in devising a strategic plan for improvement.
5. Be cognizant of independent third-party evaluations of culture and rankings; be vigilant about existing information online and in other public forums, noting the legitimacy of sources.
6. Have consistent communication to all stakeholders regarding cultural objectives in order to create awareness and a sense of transparency.
7. Implement a system for monitoring cultural developments and consequences. For example, institute "culture committees" within the board and the employee ranks. Have these culture committees meet regularly to implement actions that will foster a cohesive development of cultural goals.
8. Be self-critical and responsive to feedback.

While a focus on culture may be a shift from traditional business practice, the importance of adopting this new perspective is only further underscored by the August 2019 Business Roundtable announcement emphasizing the impact of — and need for increased focus on — the role of employers in our society, including as it relates to investment in employees, customers, suppliers, communities and investors.[6]

Bottom line: Management of corporate culture is essential.

[6] *See* Press Release, Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'" (August 19, 2019).

SHAREHOLDER PROPOSALS 2019

In this section, we provide in-depth analysis of trends we see in shareholder proposals through a review of the management and shareholder proposals voted on by the U.S.-based S&P 500 companies. We also examine trends and strategies in company responses to ESG-related shareholder proposals by examining requirements for SEC no action letter relief to exclude proposals in the 2019 proxy season.

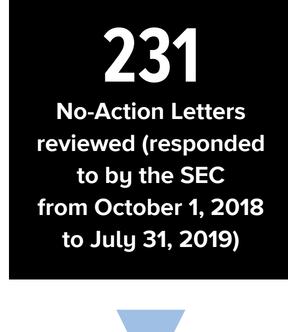
INSIGHTS

Richard B. Alsop and
Yoon-jee Kim

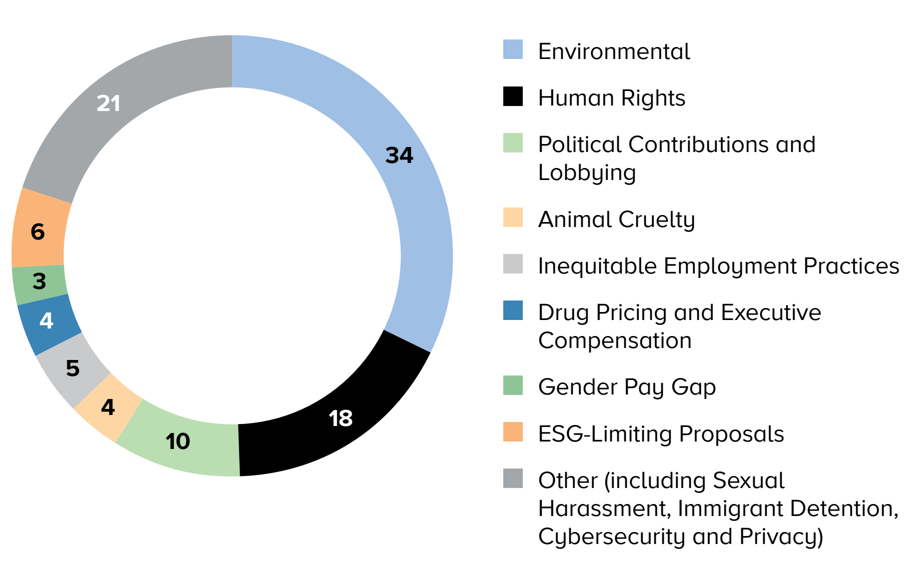
SHAREHOLDER PROPOSALS 2019 — ESG NO-ACTION LETTER TRENDS AND STRATEGIES

Shareholder proposals relating to ESG matters are frequent targets for exclusion by companies, and based upon a survey of the no-action letters submitted during the 2019 proxy season, this trend continues. Over 40% of the no-action letters we reviewed for the 2019 proxy season related to a variety of ESG matters, and the arguments and outcomes in those letters are instructive as to how companies and the SEC staff are approaching ESG proposals, especially in the wake of recent SEC staff guidance on its approach to requests based on the "economic relevance" (Rule 14a-8(i)(5)) and "ordinary business" (Rule 14a-8(i)(7)) exemptions, which are frequently cited grounds for excluding ESG-related shareholder proposals.[1]

In terms of the subject matter of proposals for which exclusion was sought, the largest group related to environmental matters, sustainability and climate change, accounting for 34 out of the 105 ESG-related no-action letters we reviewed. Human rights issues also continued to appear as the subject of numerous proposals for which no-action letters were submitted, accounting for 18 no-action letters. Other shareholder proposal topics giving rise to no-action letters included topics such as political contributions and lobbying (ten), animal cruelty (five), drug pricing (four) and proposals relating to inequitable employment practices and the gender pay gap (eight). Other proposal topics that spawned no-action letters included "me too," hate speech, immigrant detainees, diversity and privacy.



ESG-Related No-Action Letter Topics

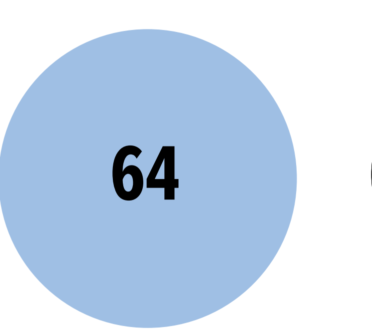


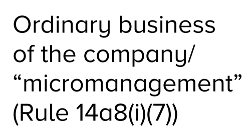
[1] 231 no-action letters responded to by the SEC staff from October 1, 2018 through July 31, 2019 were reviewed. 105 of these letters were categorized as relating to ESG matters, excluding what were categorized as "ordinary" corporate governance proposals relating to matters such as board declassification or the right to call special meetings.

ESG-RELATED NO-ACTION LETTERS – BASES FOR EXCLUSION*

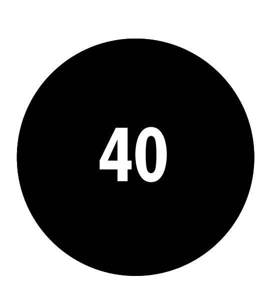
Further patterns emerged in the approaches issuers took to exclude ESG-related proposals. The most common bases for requesting exclusion (setting aside technical bases such as the failure to meet the conditions of Rule 14a-8 or duplicating other proposals) were that the proposal:

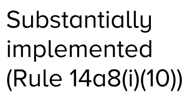
- related to the ordinary business of the company or micromanaged the company (Rule 14a-8(i)(7))
- that it had been substantially implemented (Rule 14a-8(i)(10)) or
- was economically irrelevant (Rule 14a-8(i)(5))





Ordinary business of the company/ "micromanagement" (Rule 14a8(i)(7))





Substantially implemented (Rule 14a8(i)(10))

Economically irrelevant (Rule 14a8(i)(5))

* Many companies use multiple bases of exclusion in their no-action letter requests.

SEC STAFF GUIDANCE ON "ECONOMIC RELEVANCE" AND "ORDINARY BUSINESS"

The SEC published Staff Legal Bulletin 14I (SLB 14I) in November 2017, and, after one proxy season of experience with it, published Staff Legal Bulletin 14J (SLB 14J) in October 2018. This guidance applies to the tests for exclusion under the economic relevance exception under Rule 14a-8(i)(5) and the exclusion for ordinary business under Rule 14a-8(i)(7), which are summarized below:

"economic relevance"

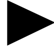
The test for exclusion under the economic relevance exception under Rule 14a-8(i)(5) has the following two requirements to exclude a shareholder proposal:

The first requirement is that the shareholder proposal relates to operations that account for less than 5% of a company's total assets, net earnings and gross sales

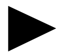
The second requirement is that the shareholder proposal is not otherwise significantly related to the company's business

"ordinary business"

The test for exclusion under the ordinary business exception under Rule 14a-8(i)(7) has the following two alternatives:



The first alternative allows exclusion if a proposal's subject matter is so fundamental to management's ability to run the company day to day that it could not be subject to direct shareholder oversight, unless the subject matter involves "significant policy issues," which are ones that transcend ordinary business and are appropriate for a shareholder vote



The second alternative allows exclusion if the proposal seeks to "micro-manage" the company by probing too deeply into matters of a complex nature on which shareholders would not be in a position to make an informed judgment

Prior to SLB 14I, the SEC staff took a more direct role in determining whether a proposal related to a significant policy issue. In doing so, the SEC staff considered a number of factors, including the degree of public attention given to an issue, press and other media coverage and legislative or regulatory activity, which were referenced by proponents to support their arguments. In SLB 14I, the SEC staff indicated that it believes a company's board is "well situated to analyze and determine and explain whether a particular issue is sufficiently significant" to prevent exclusion under the economic relevance or ordinary business exceptions. To that end, the SEC staff indicated that it would expect to see a discussion of the specific processes employed by the board to assess whether the issue transcends its ordinary business operations or if the issue is significantly related to its business.

After the SEC staff issued SLB 14I, there was speculation that a discussion of the board's analysis and consideration of the subject matter of a shareholder proposal might lead to more exclusions based on economic relevance or ordinary business, based on deference to the judgment of the board. However, it was not at all clear after the 2018 proxy season that the SEC staff's new approach in SLB 14I had resulted in measurable benefits for companies and proponents in terms of more clarity in the process. Virtually every proposal submitted on economic relevance during the 2018 proxy season or ordinary business grounds included a discussion of the process and analysis performed by the board or a committee. However, the outcomes indicated that the SEC staff did not really defer to the determination of the board on policy issues, particularly where the SEC staff had historically taken a consistent position on social policy issues like political contributions and lobbying. The SEC staff also seemed to give more weight to significant shareholder support in a prior shareholder vote on the same matter than to any analysis and determination by the board.[2]

In SLB 14J, the SEC staff discussed board analyses again, noting that in the 2018 proxy season, the most helpful board analyses discussed not only the process followed by the board and the board's conclusions, but also the substantive factors that the board took into consideration. SLB 14J stated that the SEC staff continues to believe that a well-developed discussion of the board's analysis of whether the particular policy issue raised by the proposal is "otherwise significantly related to the company's business," in the case of Rule 14a-8(i)(5), or is "sufficiently significant" in relation to the company, in the case of Rule 14a-8(i)(7), can assist the staff in evaluating a company's no-action request. SLB 14J notes that the absence of a board analysis will not create a presumption against exclusion, but that the absence of the board's insights may make it more difficult for the SEC staff to agree that a proposal may be excluded.

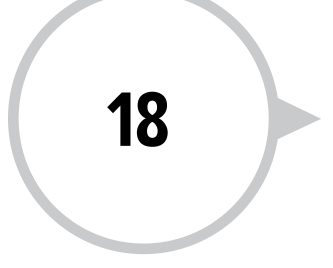
SLB 14J enumerated some of the substantive factors considered by the board that might be discussed in a well-developed board analysis, including:

- The extent to which the proposal relates to core business activities
- Quantitative data, including financial statement impact, related to the matter that illustrates whether or not it is significant to the company
- Whether the company has already taken action on the subject matter, and if so, the differences between the proposal and the action taken and an analysis of whether the differences present a significant policy issue
- The extent of shareholder engagement and interest
- Whether anyone other than the proponent has requested the type of action sought by the proposal
- Whether the shareholders have previously voted on the subject matter and the board's views as to the related voting results

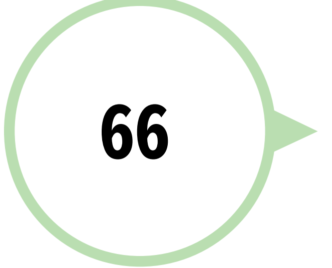
[2] *See* Shearman & Sterling LLP, Corporate Governance Survey 2018, "Shareholder Proposals 2018 — Was 14i Really a Game Changer?"

With respect to prior shareholder votes, SLB 14J states that the SEC staff would expect any board discussion to adequately address the voting results. The SEC staff will consider the discussion of previous shareholder votes as part of the total mix of information relating to the proposal, and the weight given to such votes will depend on the specific facts and circumstances. Where a previous proposal received significant support, the SEC staff will consider intervening events or actions by the company that may have mitigated the significance of the issue. Where a previous proposal received insignificant support, the SEC staff will consider whether intervening events or actions may have increased the significance of the proposal. Lastly, the time elapsed since the previous vote will be considered, with a more recent vote being more relevant to the analysis.

After the 2018 proxy season, there was considerable speculation as to whether companies would continue to engage their boards on economic relevance and ordinary business exclusion analyses, or if the relative ineffectiveness of the approach (as a basis for exclusion for shareholder proposals) would discourage companies from taking up the board's time on these reviews of shareholder proposals. Based on our review of the 105 ESG-related no-action requests from the 2019 season, relatively few (18) included the type of board analysis that was introduced by SLB 14I, suggesting that after the initial issuer enthusiasm about the new approach, companies may now be more reluctant to take up the board's time on these detailed discussions and analyses in light of the limited successes evidenced in the results of last year's proxy season. Companies may have been further emboldened by the SEC staff's comment in SLB 14J to the effect that the absence of a discussion of the board's analysis creates no presumption against exclusion.



of the 105 ESG-related no-action letters included discussion of board analysis of the shareholder proposal.



of the 105 ESG-related no-action letters cited (i)(5) or (i)(7) or both.

CASE STUDY

BOARD ANALYSIS REFERENCED IN SEC RESPONSES

As mentioned above, there is considerable debate about the benefits and burdens of performing the type of board analysis referenced in SLB 14I and SLB 14J, and we observed that a number of the no-action letters that did include a description of the board process and analysis either did not receive no-action relief on such basis or received relief on other grounds, such as micromanagement or substantial implementation, as discussed below. There were, however, two letters where the SEC staff response specifically referenced the presence or absence of the board's analysis, and which shed some light on this issue.

Walgreens received a shareholder proposal requesting a report describing the corporate governance changes it has implemented to more effectively monitor and manage financial and reputational risks related to the opioid crisis, including board oversight, formal designation of the issue by the company as a corporate social responsibility issue, and changes in executive compensation arrangements.[3] Walgreens sought to exclude the proposal based on Rule 14a-8(i)(7) both on ordinary business and micromanagement grounds. With respect to ordinary business, Walgreens argued fairly compellingly that the SEC staff had long recognized a distinction between manufacturers and retailers, permitting retailers to exclude proposals relating to products sold by them and manufactured by others, citing letters relating to retail sales of guns and tobacco, among other things. Walgreens also argued that the proposal related to specific products being offered by the chain, amounting to micromanagement. With respect to the question of whether the opioid crisis represented a significant policy issue that transcends ordinary

[3] Walgreens Boots Alliance, Inc. (November 20, 2018). All citations to no-action letters are references to letters posted on the SEC's website.

business operations, Walgreens focused on the fact that the substance of the underlying proposal related to the products offered and sold, rather than the question of whether the policy issue itself was significant and sufficiently related to the company's business, in terms of financial impact and reputational risk, to merit inclusion.

The SEC staff did not concur with Walgreens' analysis, stating, "We are unable to conclude that this particular proposal is not sufficiently significant to the company's business operations such that exclusion would be appropriate. The information presented includes neither a board analysis nor other analysis addressing the significance of the particular proposal to the company's business operations. Specifically, the company discussion does not review the significance of its dispensing (or prior distribution activity) of opioid products." It appears that in light of the overwhelming attention given to the opioid crisis in the media and among policy makers, and the breadth of the request in terms of impact on the company, the SEC staff was not prepared to make a judgment about significance to the company without the board weighing in.

Reliance Steel & Aluminum Co. was successful in excluding a proposal requesting a report on the company's policies, contributions and expenditures relating to political contributions under the economic relevance exclusion.[4] Reliance Steel & Aluminum Co. argued that it made no direct political contributions in the last five fiscal years and only its dues payable to a trade association could be characterized as an indirect political contribution, which dues were significantly below the 5% minimum threshold necessary to demonstrate economic relevance. The letter also included a description of the board's process and analysis, in which the board concluded that the proposal did not present an issue that transcends the company's ordinary business operations and lacked sufficient nexus to the company, noting the factors the board considered, including that the trade association itself makes no political contributions of any kind. In concurring on the basis of Rule 14a-8(i)(5), the SEC staff made specific reference to the board's analysis of the issue and cited some of the factors considered by the board, suggesting that as the SEC staff begins to depart from its formerly rigid approach to the economic relevance test, as it foreshadowed in SLB 14I, it intends to emphasize its reliance on the analysis of the company's board.

MICROMANAGEMENT AS A BASIS FOR EXCLUSION

As in 2018, the 2019 proxy season had numerous examples of no-action letters that sought exclusion under Rule 14a-8(i)(7) based on micromanagement. Claims of micromanagement have become more prominent as the SEC staff has become more receptive to such exclusions, even where the underlying issue represents a significant policy issue and would not likely be excluded based on subject matter alone.

Of the 105 ESG-related no-action letters we reviewed:

64 included arguments for exclusion based on micromanagement

20 of the letters were actually decided based on the micromanagement question

SLB 14J included a short discussion of micromanagement, in which the SEC staff clarified that the ordinary business exemption rests on two central considerations — the first relating to the subject matter, and the second, the degree to which the proposal "micromanages" the company by probing too deeply into matters of a complex nature as to which shareholders as a group would not be in a position to make an informed judgment. SLB 14J states clearly that a proposal may be excludable if it micromanages, even if it would not otherwise be excludable based on subject matter. SLB 14J states that a proposal may probe too deeply into matters of a complex nature if it involves intricate detail, or seeks to impose specific timeframes or methods for implementing complex policies. As an example, SLB 14J refers to an Apple shareholder proposal that asked the company to reach net-zero greenhouse gas emissions by the year 2030, which went too far by including a specific timeframe. SLB 14J also confirms that this analysis applies equally to proposals that call for a study or report, so that a proposal requesting a report may be excludable if the substance of the report relates to the imposition or assumption of specific timeframes or methods for implementing complex policies. Given the complexity of the issues covered in many ESG-related shareholder proposals and the fact that they often ask for studies, the micromanagement prong is an important basis for companies to consider in seeking exclusion.

[4] Reliance Steel & Aluminum Co. (April 2, 2019).

CASE STUDY

MICROMANAGEMENT IN NO-ACTION REQUESTS FOR ESG-RELATED REPORTS

In the 2019 proxy season, various proponents submitted similar proposals on climate change to a number of energy companies and banks, requesting the boards of those companies to adopt targets, or to include in annual reporting a discussion of targets, or to adopt policies to reduce the carbon footprint of the company's loan and investment portfolios, in each case, in conformity with the greenhouse gas reduction goals established by the Paris Climate Agreement to keep the increase in global average temperature below two degrees Celsius.[5] In the related no-action requests, the companies argued that the proposal micromanaged the company and was therefore excludable under Rule 14a-8(i)(7). In all cases, the SEC staff concurred, finding that by imposing the overarching requirement of compliance with the Paris Climate Agreement, the proposals were seeking to impose specific methods for implementing complex policies, a task that requires the ongoing judgments of management as overseen by the board.

In contrast, Anadarko Petroleum received a proposal requesting a report describing if and how the company plans to reduce its total contribution to climate change and align its operations and investments with the Paris Agreement's goal of maintaining global temperatures [(sic)] well below two degrees Celsius.[6] The company convincingly argued that such a report would essentially force the company to adopt a company-wide quantitative and time-bound reporting system measured against the Paris Climate Agreement, but the SEC staff disagreed. While SLB 14J clearly states that a proposal calling for a report may be excludable if the substance of the report relates to the imposition or assumption of specific timeframes or methods for implementing complex policies, the SEC staff may have found a distinction from the letters referenced above based on the inclusion of the "if and how" language of the proposal.

SUBSTANTIAL IMPLEMENTATION AS A BASIS FOR EXCLUSION

Rule 14a-8(i)(10) allows a company to exclude a proposal if it has been substantially implemented. The stated purpose of the exemption is to avoid the possibility of stockholders having to consider matters that have already been favorably acted upon by management.[7] When a company can demonstrate that it has taken action to address each element of a proposal, the SEC staff has generally concurred that the proposal may be excluded based upon "substantial implementation." The proposal need not be fully implemented in order to justify exclusion.[8] Differences are permitted if the essential objectives of the proposal are satisfied, or where the actions taken by the company "compare favorably" to the actions requested in the proposal.[9]

The "substantially implemented" exemption is important in the context of ESG-related shareholder proposals, because often, the subject matter relates to matters that go to the reputation or brand of the company or implicate issues that are otherwise integral to a company's business and therefore have already been carefully considered by the board and management. As a result, companies may have already taken steps with respect to the issue, such as engaging with shareholders and other stakeholders, publishing reports or other information or developing policies with respect to the issue. Companies should, therefore, review their existing and planned actions with respect to the subject matter of the proposal to see whether they can construct a patchwork of actions that together compare favorably with the actions requested.

[5] *See* ExxonMobil Corporation (April 2, 2019), The Goldman Sachs Group, Inc. (March 12, 2019), Wells Fargo & Company (March 5, 2019), Devon Energy Corporation (March 4, 2019, reconsideration denied April 1, 2019) and J.B. Hunt Transport Services, Inc. (February 14, 2019).

[6] *See* Anadarko Petroleum Corporation (March 4, 2019).

[7] *See* SEC Release No. 34-12598 (July 7, 1976), interpreting the predecessor rule.

[8] *See* SEC Release No. 34-40018 (May 21, 1998).

[9] *See,* e.g., Apple Inc. (November 19, 2018), Amazon.com, Inc. (March 3, 2016), The Dow Chemical Company (March 18, 2014), Entergy Corporation (February 14, 2014).

CASE STUDY

SHAREHOLDER PROPOSALS SEEKING NEW BOARD COMMITTEES TO OVERSEE ESG MATTERS

A number of shareholder proposals were brought during the 2019 proxy season requesting companies to create board committees to oversee certain ESG-related topics. While several of these were successfully excluded on ordinary business grounds,[10] the outcomes of others were determined on substantially implemented grounds. Apple received a request to establish an international policy committee to oversee policies including human rights, foreign governmental relations and international relations affecting the company's international business, especially in China.[11] Verizon was asked to establish a public policy and social responsibility committee to oversee its policies and practices that relate to public policy issues that may affect the company's operations, performance, reputation and stockholder value, including, among other things, human rights, corporate social responsibility and political and lobbying activities and expenditures.[12] ExxonMobil was requested to establish a climate change committee to evaluate its strategic vision and responses to climate change, and better inform board decision making on climate issues, indicating that the charter should explicitly require the committee to engage in formal review and oversight of corporate strategy, above and beyond matters of legal compliance, to assess the company's responses to climate-related risks and opportunities, including the potential impacts of climate change on business, strategy, financial planning and the environment.[13]

In each case, the company concluded it could exclude the proposal under Rule 14a-8(i)(10) on the basis of substantial implementation after describing the existing board committee with oversight responsibility for the referenced subject matter and the extensive disclosures the company makes about oversight and policies on the relevant matters. The SEC staff concurred in the case of the Apple and Verizon requests for no-action relief, but was unable to concur in the case of the ExxonMobil letter.

It is difficult to determine whether the different outcome in ExxonMobil was related to some perceived difference in the analysis in the no-action letter requests (although that is not apparent on the face of the letters). The result in ExxonMobil may also have been based on the proposal's more specific references to charter requirements in the charter of the proposed committee that perhaps could not be demonstrated to exist in the existing board committee charters, although it would seem a bit overly technical to prevent exclusion simply because the proposal asks for specific charter language. Given the success of similar letters on the basis of the ordinary business exemption, the result suggests that companies faced with new committee proposals should base their exclusion requests on both the ordinary business and substantially implemented exemptions wherever possible.

ESG-LIMITING PROPOSALS

One interesting phenomenon in the area of ESG-related shareholder proposals is the emergence of what can only be characterized as "ESG-limiting proposals" by proponents who argue that companies should not be engaging in voluntary efforts to support environmental sustainability or other initiatives.

For example, proposals entitled "Greenwashing Audit" were brought at Duke Energy and Exelon Corporation by the same proponent, in each case, requesting an annual report on actual incurred costs and associated benefits to shareholders, public health and the environment of the company's voluntary environment-related activities.[14] In both cases, the companies were unsuccessful in excluding the proposals based on vagueness, ordinary business or substantial implementation grounds, despite a detailed discussion of the board's analysis and, in each case, noting that the proponent is a co-founder of a pro-coal special interest group and runs a website critical of climate change science, which the letters claimed puts the proponent at odds with the views of the majority of the companies' shareholders.

[10] *See,* e.g., Amazon.com, Inc. (March 28, 2019), McDonald's Corporation (March 12, 2019).

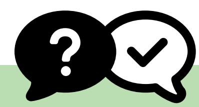
[11] *See* Apple Inc. (November 19, 2018).

[12] *See* Verizon Communications Inc. (February 19, 2019).

[13] *See* ExxonMobil Corporation (April 2, 2019).

[14] *See* Duke Energy Corporation (March 12, 2019), Exelon Corporation (March 12, 2019).

Interestingly, ExxonMobil was successful in excluding a similar proposal from a different proponent on substantial implementation grounds.[15] The proposal was worded somewhat differently, asking the board to adopt a policy not to undertake any energy savings or sustainability project based solely on alarmist climate change concerns (except where required by law), but that each project should meet financial return on investment metrics. Because of the financial focus of this proposal, as opposed to the more general consideration of the risks and benefits of engaging in sustainability efforts in other proposals, ExxonMobil was able to successfully argue substantial implementation. ExxonMobil supported its substantial implementation argument by referencing specific language in its annual report on Form 10-K, discussing its analysis of the short-term and long-term financial benefits of its projects (including those that contain a potential energy savings or sustainability component), and emphasizing that climate change risk is not just a societal issue but also represents a business opportunity, as customers are seeking solutions to mitigate those risks as well.



WHAT SHOULD COMPANIES DO NOW?

As the interest in ESG continues to grow, so will the number of shareholder proposals on ESG-related topics. As mentioned above, ESG proposals are somewhat unique in that they often relate to issues that companies and their boards have already considered in detail, and may have been the subject of public disclosures and of shareholder engagement. In the face of a new proposal on an ESG topic, companies should keep the following practical pointers in mind:

1. Inventory previous company actions on the subject matter of the proposal, including whether it has been the subject of prior board consideration, disclosure, shareholder engagement or a shareholder vote. For large and geographically broad companies, consider creating this inventory preemptively, to be ready when a proposal comes in.

2. Consider discussions with the proponent, as a means to educating the proponent about the company's existing and planned actions with respect to the subject matter of the proposal. Because ESG proposals frequently relate to issues that are already of importance to the company, this kind of engagement can sometimes secure a withdrawal.

3. Try to link each element of the proposal to an existing or planned practice, policy or disclosure of the company so as to support an argument for exclusion.

4. If the proposal relates to the company's ordinary business, consider carefully the nature of the proposal and related precedent no-action letters, then evaluate whether the type of board analysis described in SLB 14I and 14J may be critical in order to obtain exclusion. This will allow an informed balancing of the benefits and burdens of taking the board's time on the issue.

5. Consider whether the proposal can be characterized as "micromanaging" the company, which is one of the clearest paths to exclusion.

6. Consider requests for exclusion in the broader context of the company's reputation and brand and how it wishes to communicate about the issue. Consider whether the company would want to be seen as opposing a proposal which its customers and employees would be largely in favor of, although if the company includes such a proposal in its proxy statement, it will typically recommend against the proposal with an accompanying opposition statement.

[15] *See* ExxonMobil Corporation (April 2, 2019).

INSIGHTS

Stephen T. Giove, Arielle L. Katzman and Michael L. Perez

SHAREHOLDER PROPOSAL SEASON

In this section of the Survey, we present an overview of the results of both the management-sponsored and the shareholder-sponsored proposals voted on at the annual meetings of U.S.-based S&P 500 companies in 2019 (through June 30, 2019). We also highlight some of the key findings based on our review of these results.

The data in this section of the Survey was sourced from SharkRepellent.net

MANAGEMENT PROPOSALS — ROUTINE MATTERS

	2019*			2018			2017		
Proposal Type	# Props.	# Fail	Avg. % in Favor	# Props.	# Fail	Avg. % in Favor	# Props.	# Fail	Avg. % in Favor
Election of Directors	4,085	1	96.9	4,552	0	97.2	4,507	1	97.2
Ratification of Auditors	409	0	97.5	459	0	98.0	459	0	98.3
Say-on-Pay (Advisory)	393	6	90.4	444	6	91.5	459	6	92.3
Approve/Amend Equity-Based Plans	91	0	93.0	122	0	93.8	204	0	94.1
TOTAL	**4,978**	**7**	**N/A**	**5,577**	**6**	**N/A**	**5,629**	**7**	**N/A**

* Through June 30, 2019.

Election of Directors

The level of shareholder support in director elections in 2019 was consistent with the prior two years. Directors received an average vote in favor of 96.9%, and 85.6% of directors received a 95% or greater vote in favor. Approximately 13.4% of directors received a vote in favor of between 70% - 94%, 35 directors received a vote in favor of between 50% - 69% and one director was not elected.

Say-on-Pay Proposals

The level of shareholder support for say-on-pay proposals in 2019 was slightly less than the prior two years. These proposals received an average vote in favor of 90.4%, down from 91.5% in 2018 and 92.3% in 2017. A total of six proposals failed to receive a majority vote in 2019 (as was the case in 2018 and 2017), and 15 proposals received a vote in favor of between 50% - 69% (compared to 18 in 2018 and 17 in 2017).

MANAGEMENT PROPOSALS — GOVERNANCE MATTERS

	2019*			2018			2017		
Proposal Type	**# Props.**	**# Fail**	**Avg. % in Favor**	**# Props.**	**# Fail**	**Avg. % in Favor**	**# Props.**	**# Fail**	**Avg. % in Favor**
Director Remuneration	91	0	93	122	0	93.8	204	0	94.1
Eliminate/Reduce Supermajority Voting	24	10	94.8	26	11	97.8	14	8	98.8
Declassify Board	6	2	97.3	7	4	97.2	5	2	99.5
Authorize Shareholders to Call Special Meeting	5	0	96.0	16	1	79.2	3	1	91.3
Adopt/Amend NOL Rights Plan	3	0	92.9	0	0	0	2	0	88.9
Adopt Majority Voting	3	0	99.8	1	1	98.3	4	1	99.3
Approve Director Removal Without Cause	3	1	99.5	1	0	99.7	2	0	99.2
Authorize Shareholders to Act by Written Consent	3	0	97.6	2	1	94.8	0	0	0
Adopt Proxy Access	1	0	80.5	5	2	95.1	4	1	98.4
Adopt Forum Selection Provision	0	0	0	2	1	61.3	0	0	0
Approve Advance Notice Policy	0	0	0	0	0	0	1	0	99.3
TOTAL	**139**	**13**	**N/A**	**182**	**21**	**N/A**	**239**	**13**	**N/A**

* Through June 30, 2019.

Management Governance Proposals

There were slightly fewer management-sponsored proposals regarding governance matters in 2019 as compared to 2018. This decrease is likely due to the widespread adoption by S&P 500 companies of governance practices that were frequently the subject of management and shareholder proposals over the past several years and the reactions of companies to such proposals.

SHAREHOLDER PROPOSALS — GOVERNANCE "HOT TOPICS"

	2019*			2018			2017		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Require Independent Board Chair	43	0	29.7	36	0	32.5	31	0	30.9
Authorize Shareholders to Act by Written Consent	29	4	39.3	34	5	41.9	13	2	44.6
Amend Proxy Access	20	0	27.9	20	1	29.1	16	3	38.1
Amend Shareholder Right to Call Special Meeting (other than 25% to 10%)	8	3	44.5	11	0	41.4	14	1	41.1
Amend Shareholder Right to Call Special Meeting (25% to 10%)	6	0	40	31	4	40.6	4	1	39.5
Adopt Shareholder Right to Call Special Meeting	3	1	47.4	6	1	37.7	3	1	45.2
Adopt Proxy Access	2	0	23.9	4	0	26.1	19	8	46.7
TOTAL	**111**	**8**	**N/A**	**142**	**11**	**N/A**	**100**	**16**	**N/A**

* Through June 30, 2019.

Special Meeting Proposals

There was a significant decrease in shareholder proposals to amend the right of shareholders to call a special meeting, with 14 such proposals being voted on in 2019 compared to 42 in 2018 and 18 in 2017. Three proposals in 2019 received a majority vote in favor (compared to four in 2018 and two in 2017). The 42.6% average vote in favor in 2019 was slightly higher than the average vote in favor in 2018 and 2017. Specifically, in 2019, two proposals received between 45–49% support, four proposals received between 40–44% support and four proposals received between 35–39% support. Notably, in 2019, John Chevedden and his group submitted 43% of these shareholder proposals. In 2019, while zero of the six proposals which sought to reduce the threshold from 25% to 10% passed, the three proposals which passed all sought to reduce the threshold to 15%.

Independent Board Chair Proposals

Both the number of, and the level of shareholder support for, shareholder-sponsored independent board chair proposals in 2019 were consistent with both 2018 and 2017. None of these proposals passed in 2019 (as was the case in 2018 and 2017) and four proposals in 2019 received a vote in favor in excess of 40%, compared with six in 2018 and eight in 2017.

Written Consent Proposals

In 2019, the number of shareholder proposals to allow shareholders the right to act by written consent was roughly consistent with 2018 (29 versus 34), up from just 13 such proposals in 2017. Notably, four proposals in 2019 received a majority vote in favor (compared to five in 2018 and two in 2017). The average vote in favor in 2019 was 39.3%, which was lower than the average vote in favor in 2018 and 2017. Nine proposals received between 40–49.9% support in 2019, compared with 17 in 2018 and nine in 2017. Notably, from 2017 to 2019, John Chevedden and his group submitted approximately 50% of these shareholder proposals.

SHAREHOLDER PROPOSALS — SELECT ADDITIONAL GOVERNANCE MATTERS

	2019*			2018			2017		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Eliminate/Reduce Supermajority Voting	10	7	60.4	8	6	62.2	10	9	70.8
Adopt One Share One Vote	4	0	29.3	5	0	30.3	5	0	29.6
Adopt Cumulative Voting	2	0	8.3	3	0	9.4	2	0	9.7
Declassify Board	2	2	68.5	2	2	86.6	1	1	62.9
Adopt Majority Voting	1	0	4.8	1	0	7.8	8	0	7.3
Board Diversity Report/Policy	1	0	1.7	1	0	2.0	1	0	4.9
Adopt Confidential Voting Policy	0	0	0	2	0	3.5	2	0	3.2
TOTAL	**20**	**9**	**N/A**	**22**	**8**	**N/A**	**29**	**10**	**N/A**

* Through June 30, 2019.

Additional Governance Matters

In 2019, shareholders continued to submit proposals to modify a range of governance practices, with success rates comparable to those of prior years. For governance matters that have become best practices for a large number of S&P 500 companies, such as not having a classified board or supermajority voting provisions, shareholder proposals continue to have an extremely high success rate. For other governance matters, such as cumulative voting and adopting a confidential voting policy, votes in favor of these proposals continue to be very low. Interestingly, there continues to be some interest in one vote per share proposals; while none of the 14 proposals have passed over the past three years, such proposals have received an average vote in favor of approximately 30% over the prior three years.

SHAREHOLDER PROPOSALS — SELECT COMPENSATION MATTERS

	2019*			2018			2017		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Create Remuneration Report	5	0	26.3	7	0	20.7	3	0	5.6
Adopt/Amend Pro-Rata Vesting Policy	4	0	30.3	8	0	23.2	8	0	25.3
Approve Clawback Provisions	3	1	43.0	7	0	39.9	6	0	13.9
Adopt Stock Retention/ Holding Period	1	0	0.5	0	0	0	4	0	23.3
TOTAL	**13**	**1**	**N/A**	**22**	**0**	**N/A**	**21**	**0**	**N/A**

* Through June 30, 2019.

Select Compensation Matters

The number of compensation-related proposals continued to decline in 2019, although the level of shareholder support increased slightly.

SHAREHOLDER PROPOSALS — SELECT ENVIRONMENTAL AND SOCIAL MATTERS

	2019*			2018			2017		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Political/Lobbying Report	56	2	33.6	51	0	28.8	57	0	25.6
Social Issues (Various) Report	27	2	24.8	17	0	21.9	8	0	12.9
Human Rights Report	11	0	27.1	5	0	12.5	12	0	12.7
Environmental Report/Policy	10	0	24.0	9	0	26.9	8	0	27.9
Climate Change Report	7	0	27.0	3	0	15.0	5	0	14.2

* Through June 30, 2019.

SHAREHOLDER PROPOSALS — SELECT ENVIRONMENTAL AND SOCIAL MATTERS (CONTINUED)

	2019*			2018			2017		
Proposal Type	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**	**# Props.**	**# Pass**	**Avg. % in Favor**
Pay Disparity Report	7	0	23.2	4	0	20.5	12	0	15.2
Approve/Amend Diversity/ EEO Policy	5	0	10.4	5	0	29.8	11	0	25.8
Social Issues (Various) Policy	5	0	18.4	5	0	12.3	4	0	13.3
Human Rights Policy	4	0	6.0	4	0	7.5	4	0	8.0
Industrial Waste/Pollution/ GHG Emission Report	4	0	28.3	8	1	26.3	12	0	25.2
Assess Impact of "Two Degree" Scenario Report	2	0	7.6	3	2	52.8	15	3	43.0
Sustainability as Perf. Metric	1	0	11.6	0	0	0	1	0	32.0
Sustainability Report	1	0	9.7	4	2	38.4	7	1	28.0
Adopt Holy Land Principles	0	0	0	0	0	0	12	0	3.17
Charitable Contribution Report	0	0	0	1	0	3.2	4	0	2.8
Energy Policy Report/Policy	0	0	0	1	0	5.8	8	0	27.9
TOTAL	**140**	**4**	**N/A**	**120**	**5**	**N/A**	**180**	**4**	**N/A**

* Through June 30, 2019.

Select Environmental and Social Matters

There was a slight increase in the number of proposals pertaining to environmental, social and political matters voted on in 2019 compared to 2018. In 2019, as was the case in 2018 and 2017, the greatest number of proposals related to political and lobbying expenditures. Notably, two of these proposals passed in 2019 compared to zero in the prior two years.

Another noteworthy aspect of the 2019 proxy season was the increase in the number of proposals relating to reports on social issues. There were 27 such proposals in 2019, compared to 17 in 2018 and eight in 2017, with two proposals passing.

IPO GOVERNANCE PRACTICES

Since 2016, we have surveyed the corporate governance practices of newly public companies, focusing on the corporate governance provisions and practices found to be problematic under ISS voting policies initiated in 2015 and updated in 2017. The ISS voting policies were seemingly designed to influence the governance practices of companies considering an initial public offering in the United States by recommending a vote against directors of newly public companies due to the adoption of governance policies that diminish shareholder rights. This year, we look back on our surveys of IPO companies since 2015 to consider whether the voting policies have had a significant impact over time.

INSIGHTS

Richard B. Alsop and
Yoon-jee Kim

IPO CORPORATE GOVERNANCE

In 2016, we began examining the impact of the new voting policy initiated by ISS in its Executive Summary of 2016 Global Benchmark Policy Updates published in November 2015 on the corporate governance practices of newly public companies. The voting policy recommended a vote against directors of newly public companies due to the adoption, prior to or in connection with an IPO, of bylaws or charter provisions that adversely impact shareholder rights, focusing on (i) the level of impairment of shareholder rights caused by the provision, (ii) the shareholders' rights disclosed rationale for adopting the provision, (iii) the ability to change the governance structure in the future, (iv) the ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board structure, and (v) a public commitment to put the provision to a shareholder vote within three years of the IPO.

ISS has updated its policy in 2017 to expand the adverse vote recommendation to directors of IPO companies with a multi-class capital structure with unequal voting rights. ISS also removed as a positive factor in the policy the public commitment by the company to have a shareholder vote on the provision within three years of its IPO. In its place, ISS included a more stringent requirement of a reasonable sunset provision with the intention of ensuring that the adverse practice is eventually eliminated.

THE ISS POLICY

The ISS voting policy states that for newly public companies, ISS will generally vote against or withhold votes from individual directors, committee members or the entire board (except new nominees, who are considered on a case-by-case basis) if, prior to or in connection with the company's IPO, the company or its board adopted bylaw or charter provisions materially adverse to shareholder rights or implemented a multi-class capital structure in which the classes have unequal voting rights. ISS considers the following factors when making its voting recommendation:

Level of impairment of shareholders' rights

Disclosed rationale

Ability to change the governance structure (e.g., limitations on shareholders' right to amend the bylaws or charter, or supermajority vote requirements)

Ability of shareholders to hold directors accountable through annual director elections, or whether the company has a classified board

Any reasonable sunset provision

Other relevant factors

Although the ISS policy does not define "charter provisions materially adverse to shareholder rights," the ISS policy on director performance evaluation identifies problematic provisions to include:

- a classified board structure
- a supermajority vote requirement
- either a plurality vote standard in uncontested director elections or a majority vote standard contested director elections
- the inability of shareholders to call special meetings
- the inability of shareholders to act by written consent
- a multi-class capital structure and/or
- a non-shareholder approved poison pill

For subsequent years, ISS recommends that unless the adverse provision and/or problematic capital structure is reversed or removed, votes for director nominees should be on a case-by-case basis.

INVESTOR CONSIDERATIONS FOR IPO COMPANIES

There are a number of key factors that frame the way investors think about IPO companies versus established public companies.

Purchase is Approval
IPO investors have effectively approved the company's corporate governance policies (as detailed in a comprehensive disclosure document) by deciding to purchase stock in the IPO.

Investment Thesis
IPO investors are buying into an investment thesis involving a particular management team and business model, which doesn't rely on a sale or take-out as the most likely path to a successful monetization of the investment. Therefore, they are fairly insensitive to anti-takeover measures.

Vulnerability
An IPO typically involves a business with a projected growth trajectory unlikely to be achieved in a more mature company, and the company is executing the plan when it has significant vulnerabilities relating to, among other things, access to capital, market presence, competition, diversification, personnel and stock price volatility.

Control
Many IPO companies remain majority-controlled after going public, making the concerns over anti-takeover measures largely irrelevant.

Dual-Track Processes
In many cases, sellers will approach potential strategic and financial acquirers at the same time as they prepare for an IPO. In such cases, the possibility of better value from a strategic or financial buyer has already been tested and reasonable anti-takeover measures are not likely to significantly disadvantage public shareholders.

New and Evolving Board
Under stock exchange rules, there are transition periods for moving to majority independent board committees, which are delayed for controlled companies. As a result, IPO company boards are often in a slow transition to independence. Membership is therefore in flux and the board is still in the process of developing a business and governance culture.

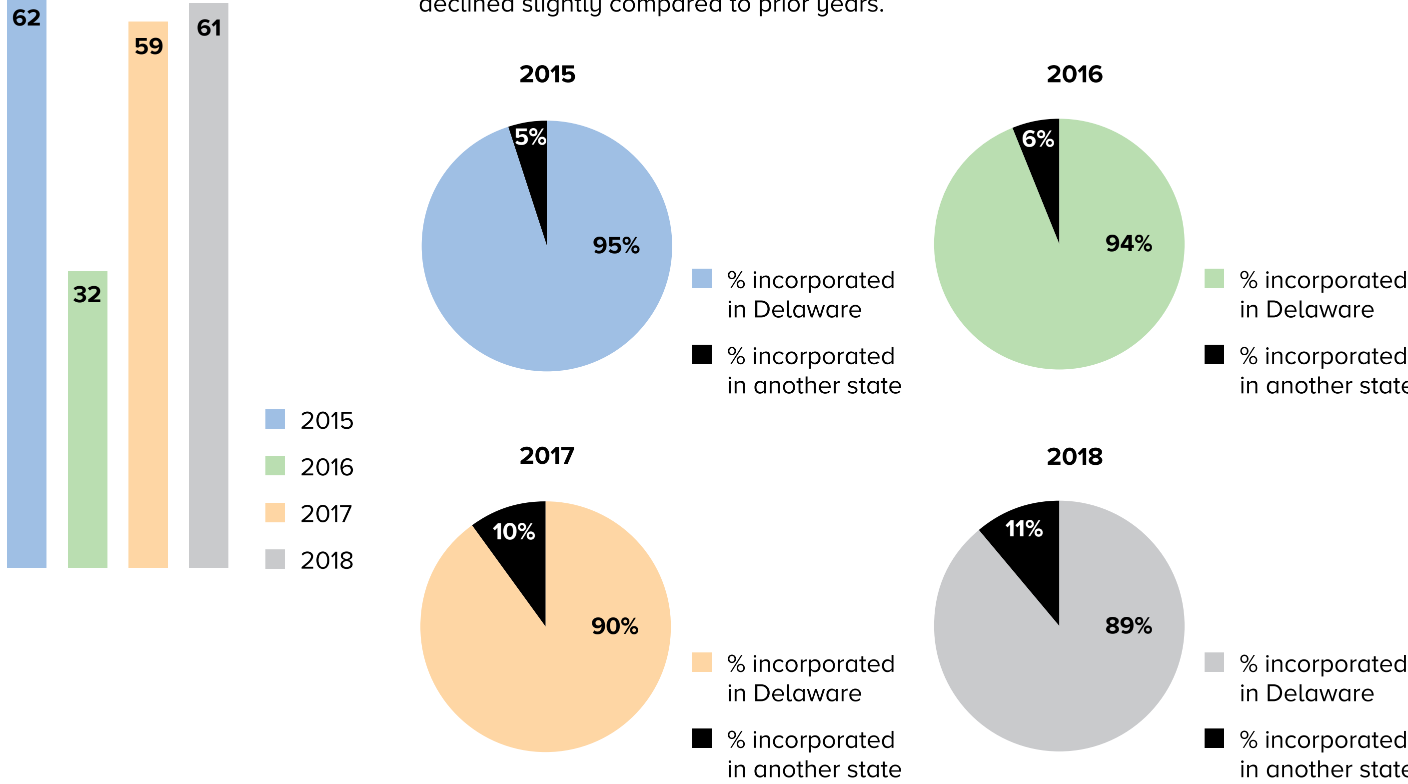
COMPARING IPOS FROM 2015 TO 2018

In order to evaluate the impact of the ISS policy and voting recommendations, we examined IPOs that were priced with a size of at least $100 million to analyze governance practices that we would expect to be considered problematic by ISS. Foreign private issuers, special purpose acquisition companies, master limited partnerships and real estate investment trusts were excluded. IPOs were roughly evenly split between the NYSE and Nasdaq.

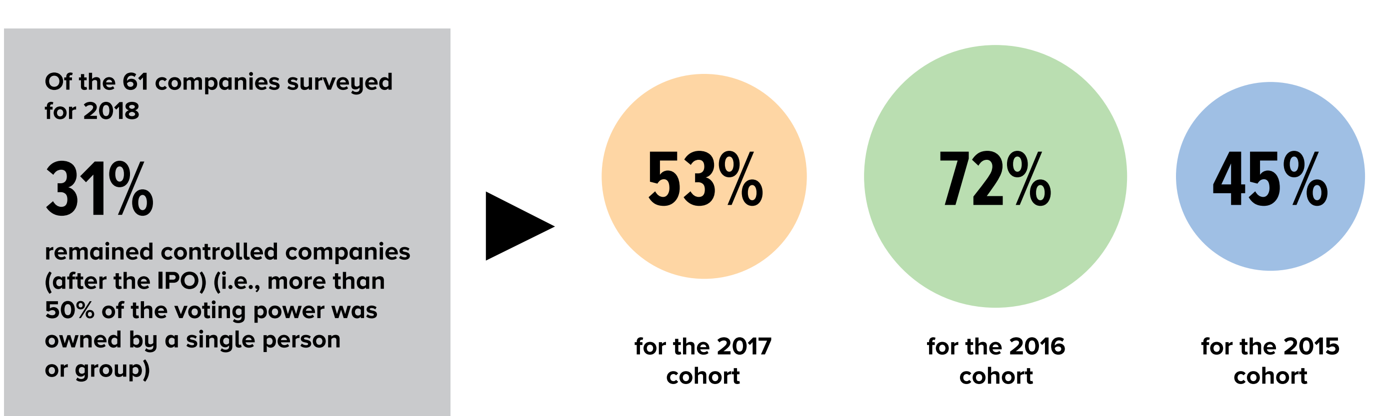
Number of IPOs surveyed

State of Incorporation

Although Delaware continues to be the most popular state of incorporation for IPO companies, the percentage of Delaware-domiciled corporations in 2018 again declined slightly compared to prior years.

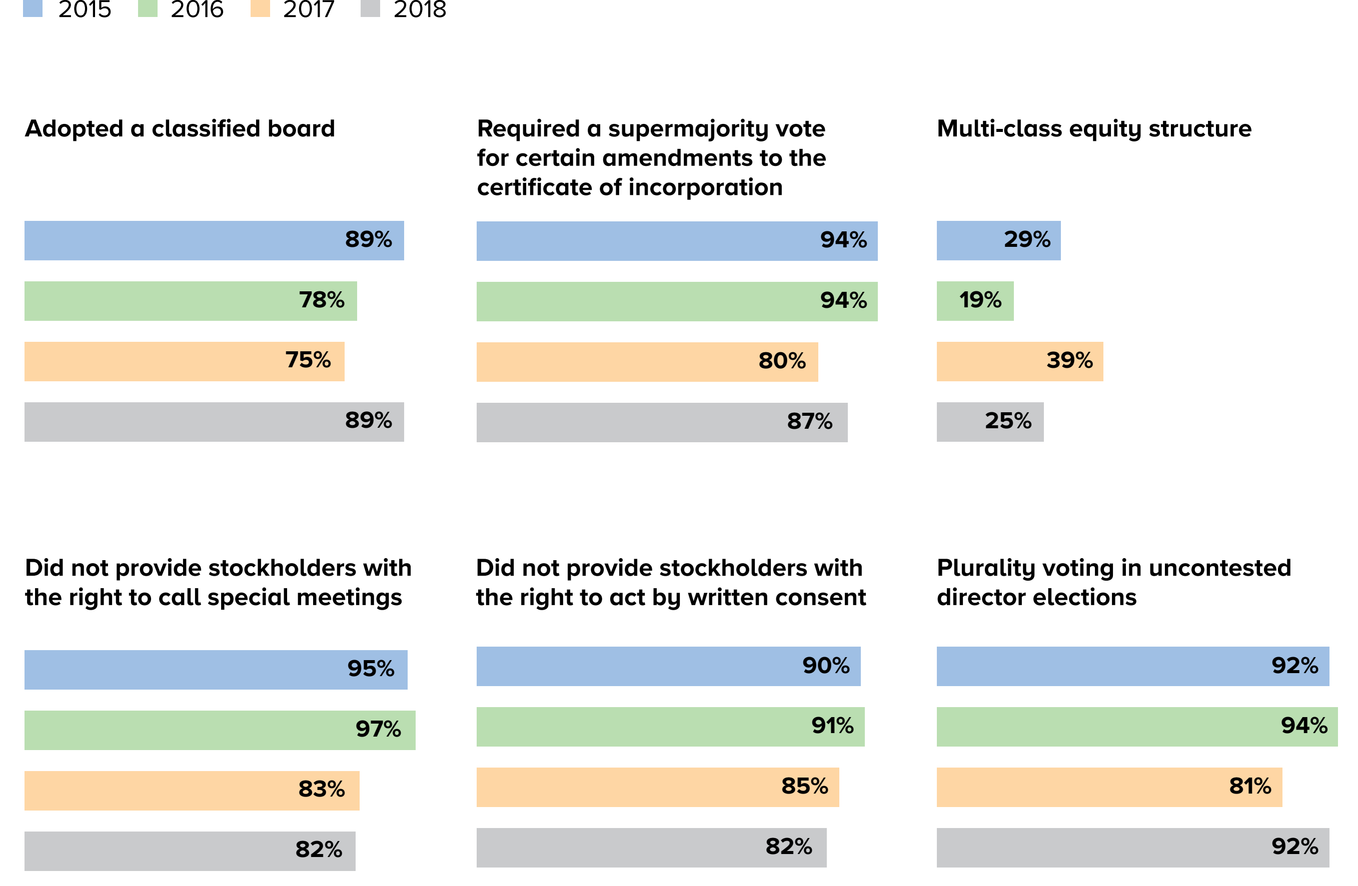


Controlled Companies

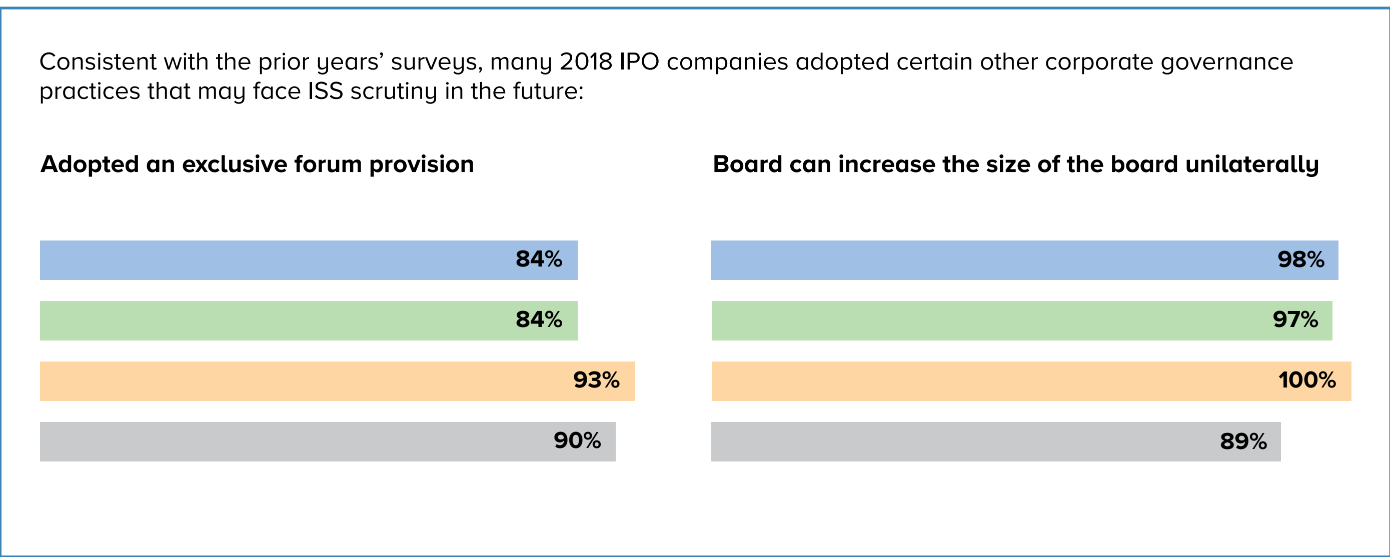


GOVERNANCE PRACTICES ADOPTED BY IPO COMPANIES

Despite the percentage of companies adopting a classified board and supermajority voting provisions decreasing in 2017 compared to 2016, the first year the ISS policy on newly public companies went into effect, 2018 saw a return to 2015 levels in the percentage of IPO companies adopting classified boards and supermajority voting provisions. With regards to multi-class equity structures among IPO companies, it seems that 2017 was an outlier and there was a reduction in the percentage of IPO companies that involved multi-class equity structures. The percentage of IPO companies in 2018 permitting stockholders to call special meetings and act by written consent stayed consistent with 2017 levels, while the percentage of IPO companies adopting plurality voting in uncontested director elections increased back to pre-2017 levels.



Consistent with the prior years' surveys, many 2018 IPO companies adopted certain other corporate governance practices that may face ISS scrutiny in the future:



CONCLUSION

When the ISS voting policies on the corporate governance practices of newly public companies were initiated in 2015, we expected law firms and banks would initially advise IPO companies not to overreact to the then-new ISS policy as investors have traditionally been relatively insensitive to the specifics of corporate governance practices for newly public companies. Our survey of IPO companies from 2015 through 2018 has shown that companies continue to adopt the corporate governance practices that work for them, regardless of ISS voting policies. While boards of newly public companies should be aware of ISS voting recommendations and corporate governance trends, and consider whether certain governance practices would benefit the company, boards do not seem to be overly concerned about adopting policies simply to fit within ISS voting policies.

THE SURVEY

The Survey consists of a review of key governance characteristics of the Top 100 Companies, including a review of key ESG matters.

46

of the Top 100 Companies had 30% or more women on the board

84

of the Top 100 Companies disclosed the board's oversight of ESG matters in their proxy statement

36

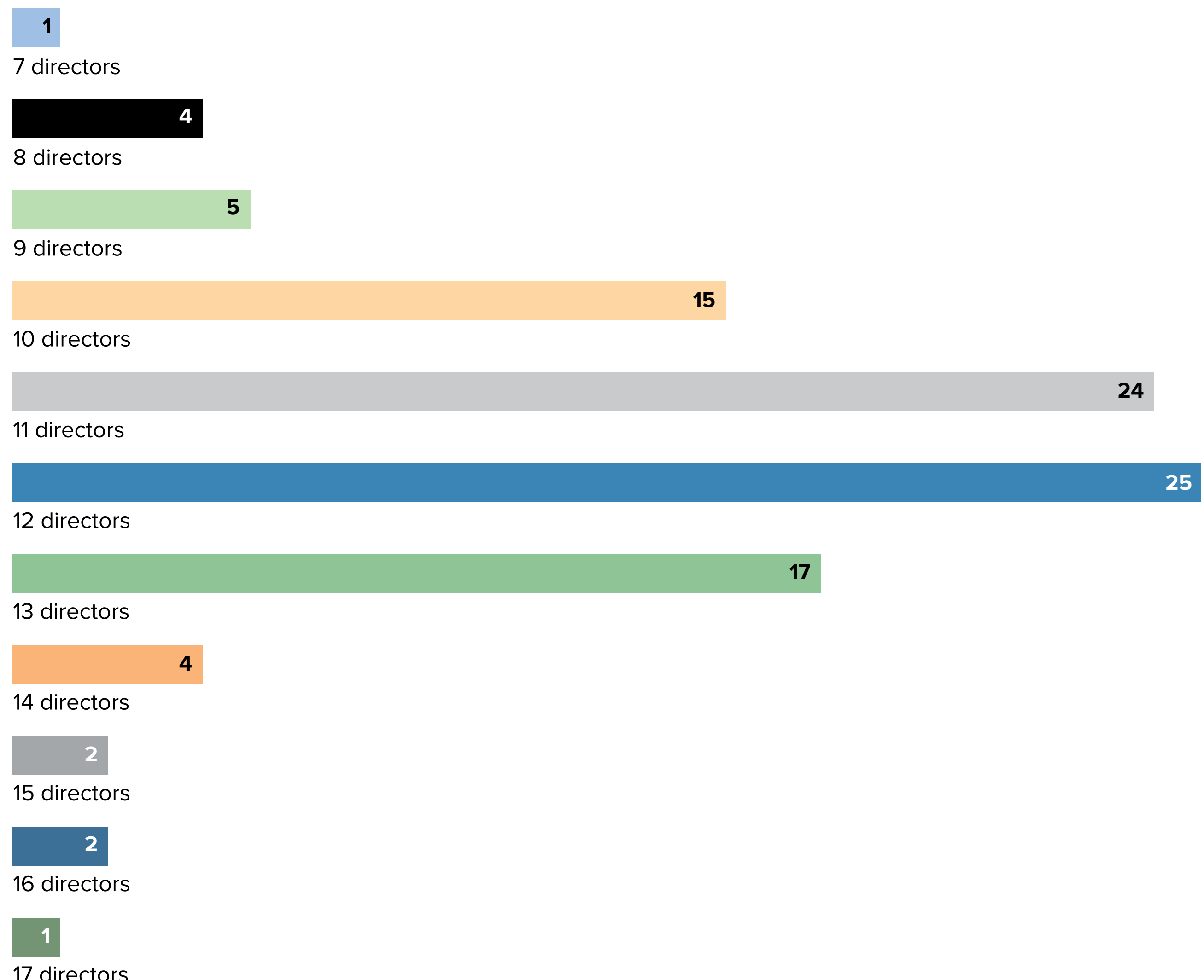
of the Top 100 Companies saw a decrease in their pay ratio

DATA

BOARD SIZE AND LEADERSHIP

Over the last five years, the average size of the boards of the Top 100 Companies has decreased from 12.5 directors in 2015 to 11.8 directors in 2019. 27 of the 38 Top 100 Companies that have separated the CEO and board chair positions have independent board chairs.

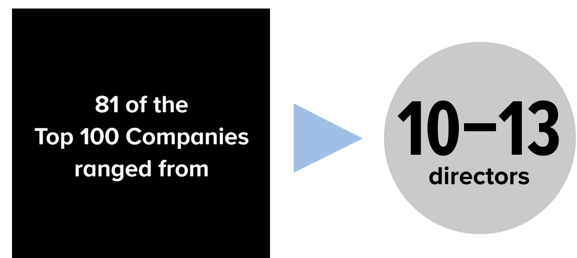
BOARD SIZE OF THE TOP 100 COMPANIES



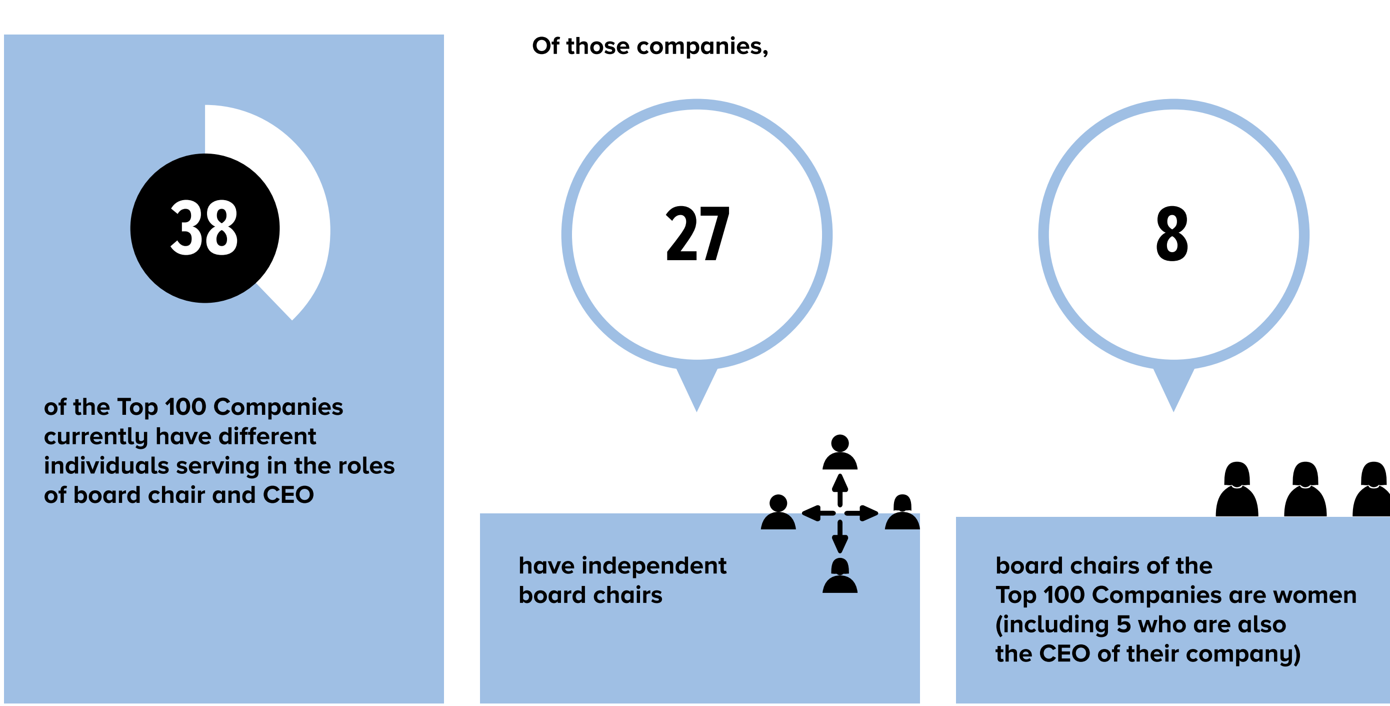
SIZE OF THE BOARD

The board size of the Top 100 Companies ranged from:

The board size of:



SEPARATION OF THE CEO AND CHAIR

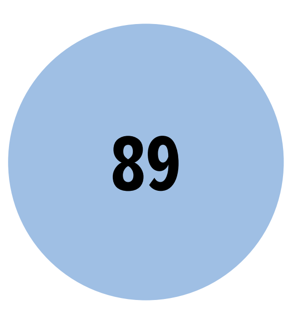


DIRECTOR INDEPENDENCE

Independent directors constituted **an average of**

87%

of the directors on the boards of the Top 100 Companies. Over the last 10 years, the number of companies at which the CEO is the only non-independent director has increased significantly.

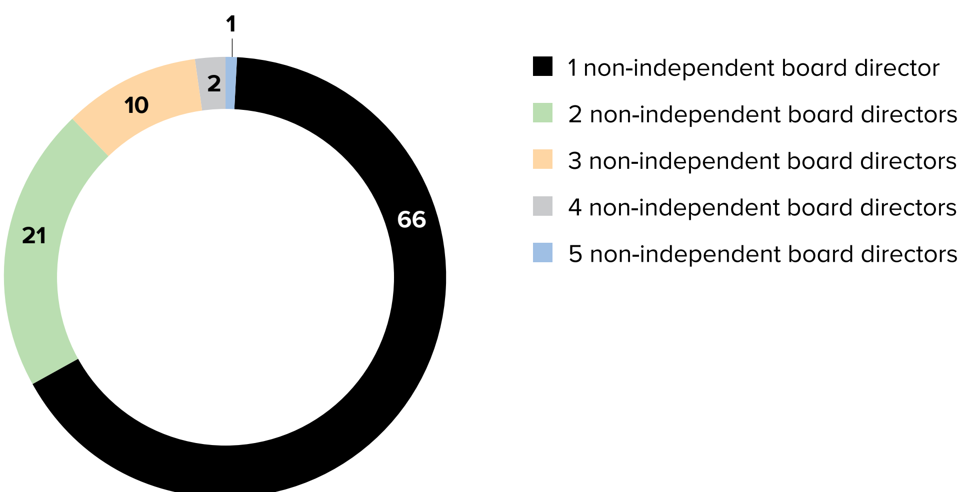


of the Top 100 Companies have boards composed of 75% or more independent directors

of the Top 100 Companies have management directors (other than the CEO) who are not independent, including 4 Top 100 Companies that have their COO on the board

of the Top 100 Companies have non-management directors who are not independent

NON-INDEPENDENT DIRECTORS*

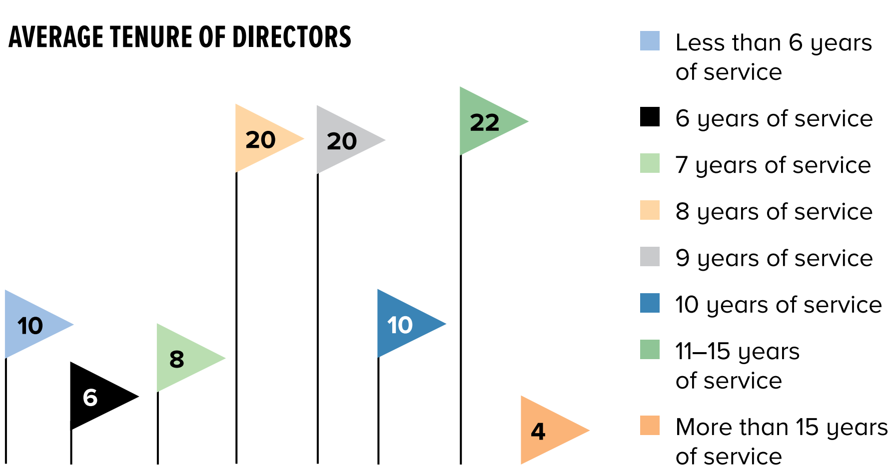


* Includes one company where the two non-independent directors are co-CEOs.

BOARD REFRESHMENT

Board refreshment continues to be one of the "hot issues" facing nominating and governance committees and boards as a whole as they are increasingly under pressure to change the face of the boardroom by reexamining topics such as director tenure, experience, performance and diversity, with gender and ethnic diversity at the forefront.

AVERAGE TENURE OF DIRECTORS



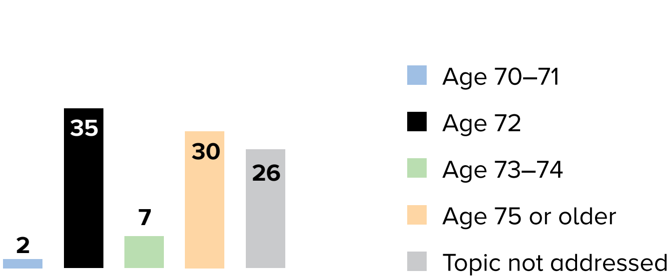
The average board tenure at the Top 100 Companies is 8 years.

MECHANISMS TO ENCOURAGE BOARD REFRESHMENT

Three of the principal board refreshment mechanisms are mandatory retirement age, term limits and the board self-evaluation process. While the use of a mandatory retirement age mechanism continues to be high and term limits continue to be low, use of the board self-evaluation process mechanism appears to be increasing.

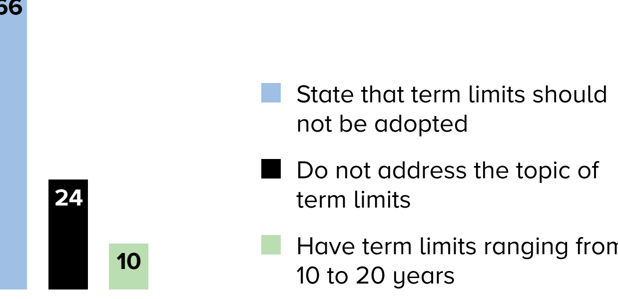
MANDATORY RETIREMENT AGE

Although not required by either the NYSE or Nasdaq listing standards, 74 of the Top 100 Companies have disclosed a mandatory retirement age for their non-management directors. Of these, 40 companies expressly permit the board or a committee of the board to make exceptions to the retirement age policy. Similar to 2018, age 72 continues to be the most commonly selected mandatory age for directors to retire from the board when they retire from employment with the company. Mandatory age of 75 or older increased from 24 of the Top 100 Companies in 2018 to 30 companies in 2019.



TERM LIMITS

Ten of the Top 100 Companies have adopted mandatory terms for their directors, a slight increase from 2018. The mandatory term limits apply only to non-management directors at two of these companies. Sixty-six of the Top 100 Companies specifically state that term limits have not been adopted, most citing the value of the insight and knowledge that directors who have served for an extended period of time can provide about the company's business. Many of these companies also state that periodic reviews by the board or a board committee of each director's performance serve as an appropriate alternative to mandatory term limits.



DATA

WOMEN IN LEADERSHIP

WOMEN IN THE C-SUITE AT THE TOP 100 COMPANIES:

5 served as the CEO

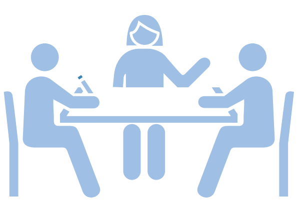
17 served as the CFO

35 served as the general counsel

1 company has both a female CEO and female CFO

WOMEN IN THE BOARDROOM

Women held approximately 28% of the total number of board seats at the Top 100 Companies in 2019, up from 26% in 2018. The number of Top 100 Companies with a board comprised of 30% or more women rose from 35 companies to 46 companies over the past year. Ten of the Top 100 Companies have a board with 40% or more women members, up from five in 2018.



GENDER DIVERSITY ON THE BOARD

(% of women on the board)

% of women on the board	Companies
Less than 10%	3
10% – 15%	3
16% – 20%	17
21% – 25%	22
26% – 29%	9
30% – 39%	36
40% or more	10

FAST FACTS

AVERAGE AGE AND TENURE

The average age and tenure of female directors is less than male directors

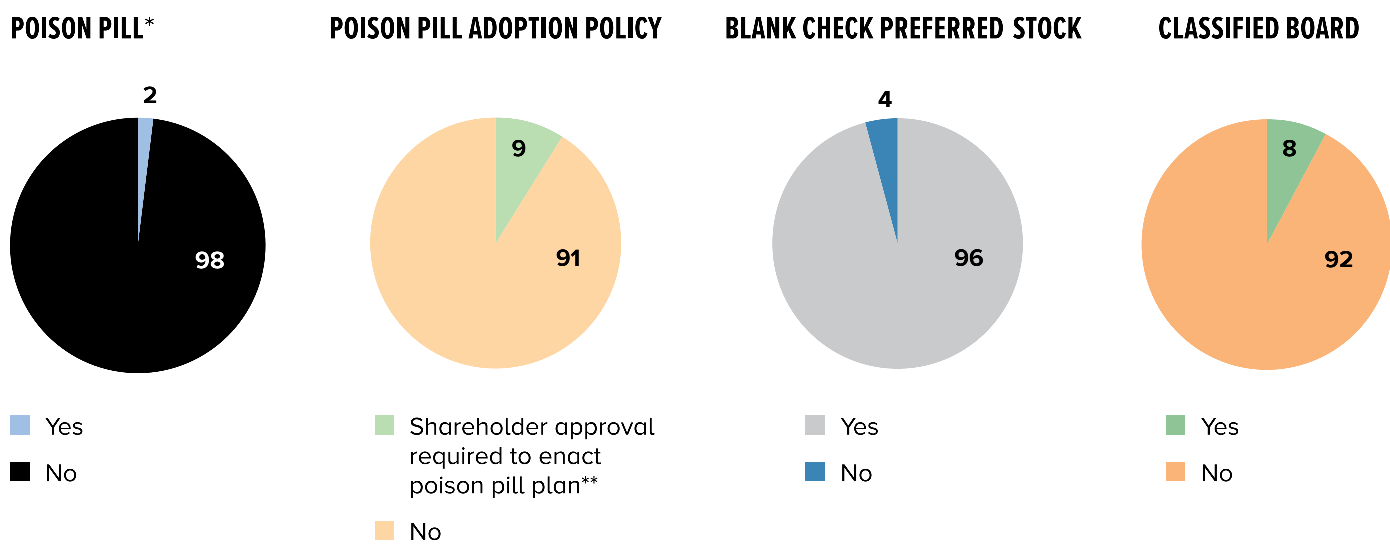
Men: **63.2** ▶ **8.6** years

Women: **60.6** ▶ **6.6** years

DATA

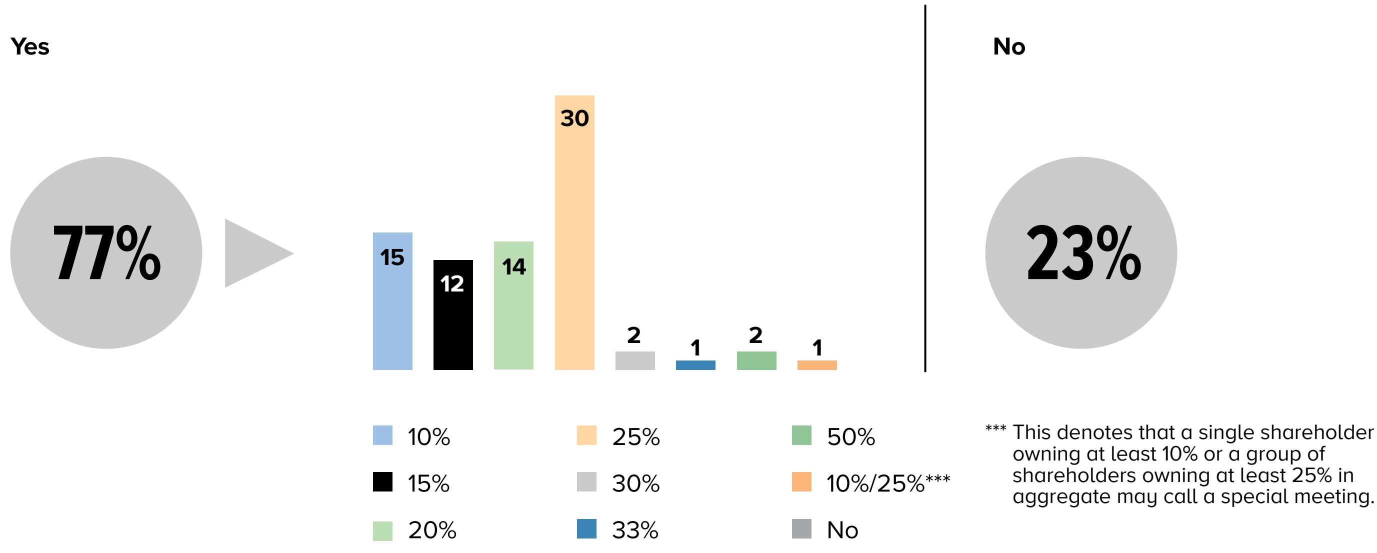
ANTI-TAKEOVER PROVISIONS

Shareholder ability to call a special meeting and to act by written consent continued to be focused on by companies, their boards as well as shareholders in 2019.



* Reflects the number of companies that have currently effective poison pill plans in place.

** Six stipulate that plan adopted by the board without prior shareholder approval will expire within one year of adoption unless ratified by the shareholders; three stipulate that shareholder approval is required, of which two are also subject to a fiduciary-out clause.

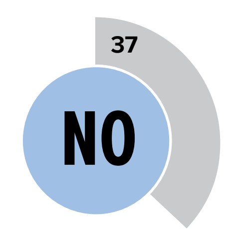


*** This denotes that a single shareholder owning at least 10% or a group of shareholders owning at least 25% in aggregate may call a special meeting.

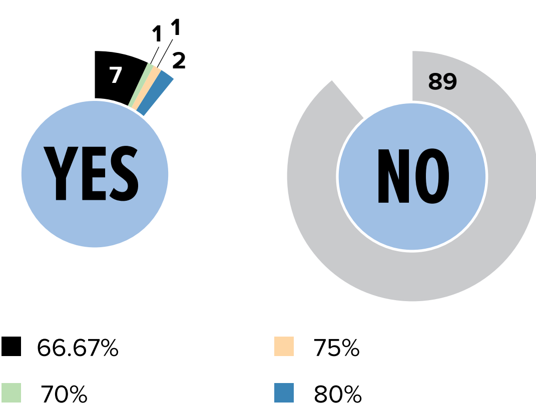
SHAREHOLDER ABILITY TO ACT BY WRITTEN CONSENT

63

YES

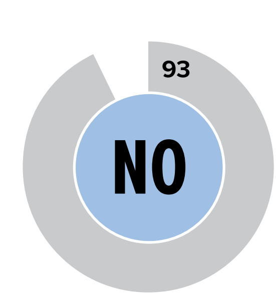


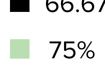
SUPERMAJORITY VOTING FOR MERGERS



- 66.67%
- 70%
- 75%
- 80%

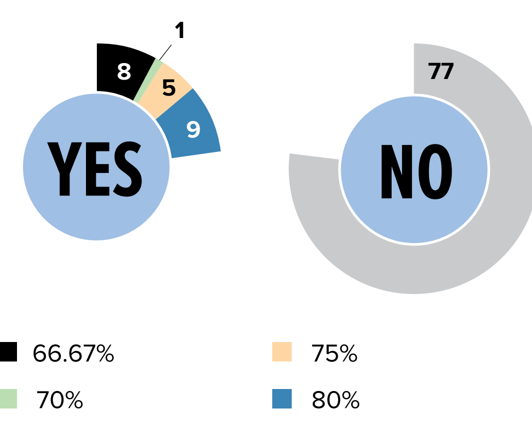
SUPERMAJORITY VOTING FOR DIRECTOR REMOVAL



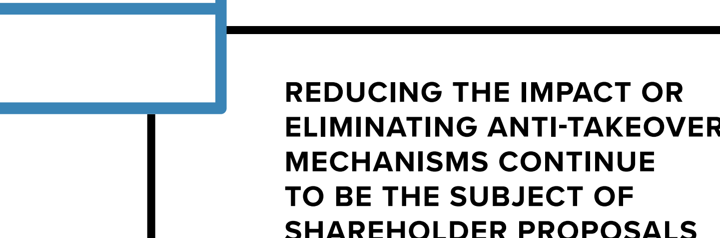


- 66.67%
- 75%
- 80%

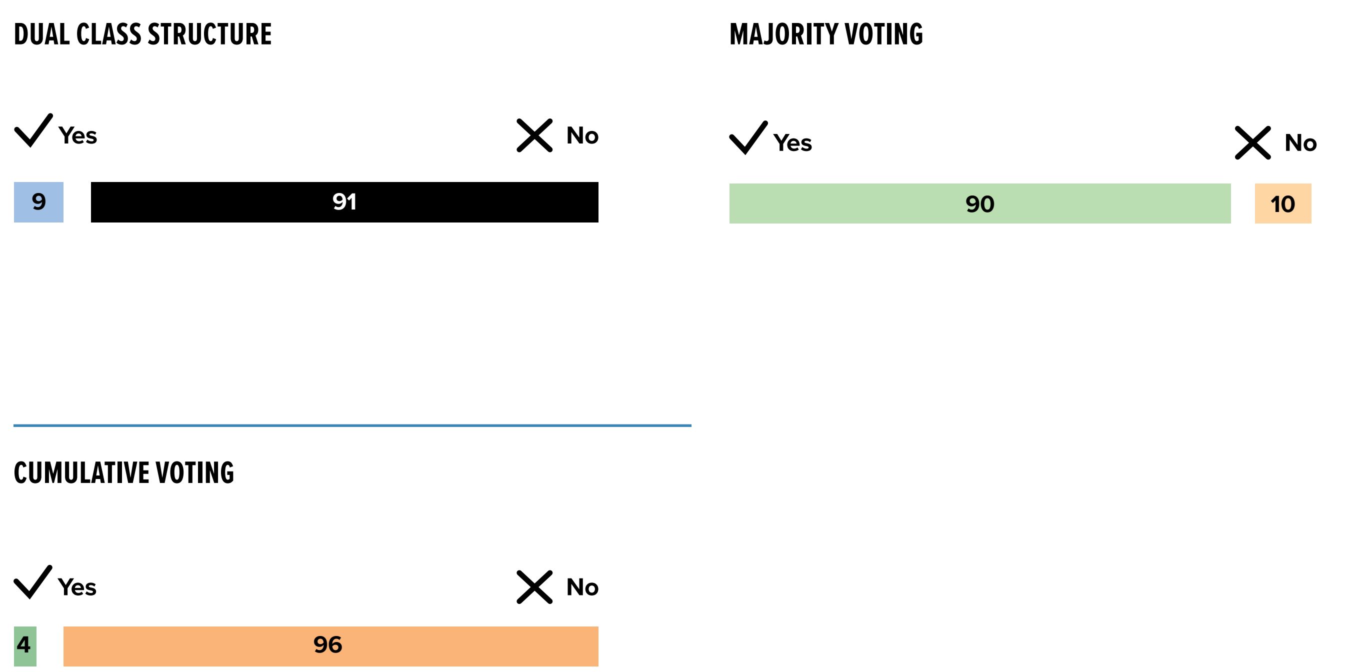
SUPERMAJORITY VOTING TO AMEND CHARTER OR BY-LAWS

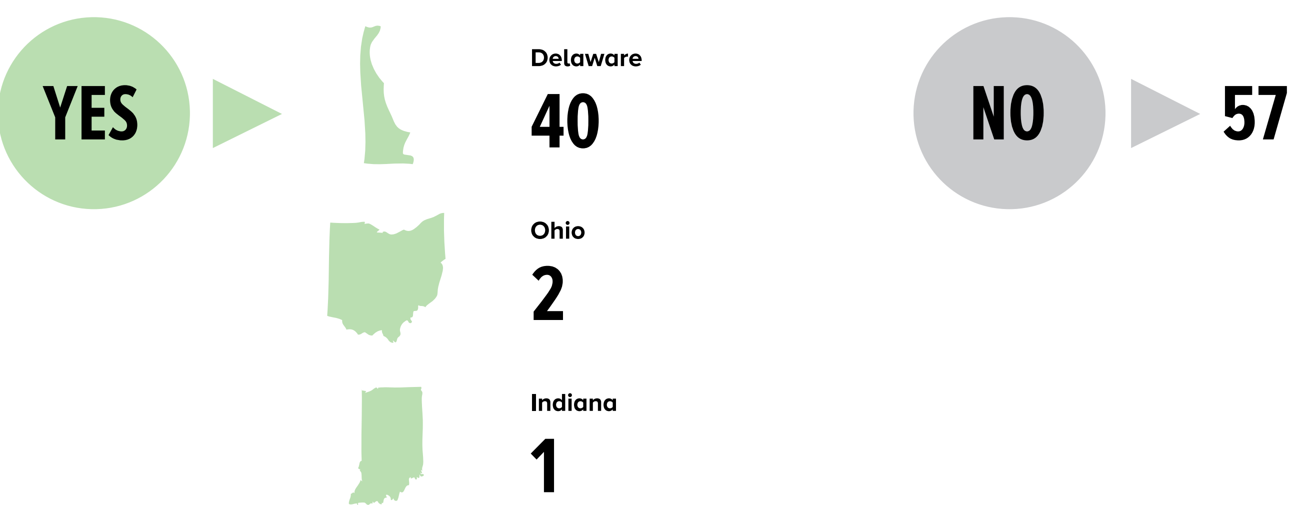


- 66.67%
- 70%
- 75%
- 80%



REDUCING THE IMPACT OR ELIMINATING ANTI-TAKEOVER MECHANISMS CONTINUE TO BE THE SUBJECT OF SHAREHOLDER PROPOSALS

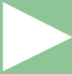

DUAL CLASS STRUCTURE
Yes
No
9
91
MAJORITY VOTING
Yes
No
90
10
CUMULATIVE VOTING
Yes
No
4
96


EXCLUSIVE FORUM SELECTION PROVISION
YES
Delaware
40
Ohio
2
Indiana
1
NO
57

DATA

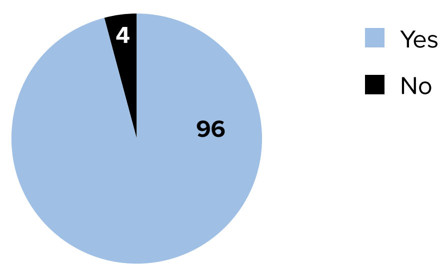
ESG DISCLOSURE AND GOVERNANCE

96 of the Top 100 Companies issued



119 CSR reports in the aggregate in 2019.

DOES THE COMPANY ISSUE A CSR REPORT?



IS THE CSR REPORT ISSUED AS A SINGLE REPORT OR IN MULTIPLE REPORTS?

85
Single Report

11
Multiple Reports

NAME OF THE CSR REPORT*

46
Corporate Social Responsibility Report

44
Sustainability/Environmental Report

10
Citizenship Report

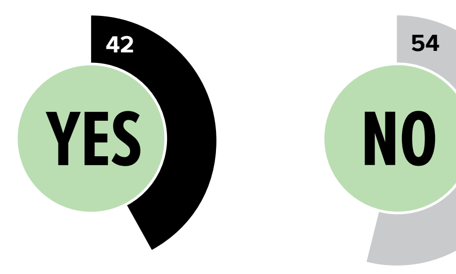
6
Impact Report

4
ESG Report

9
Other

* A total of 119 reports were published by the Top 100 Companies. 85 of the Top 100 Companies published one report, six published two reports, three published three reports, one published four reports and one published five reports.

DOES THE COMPANY ANNOUNCE THE ISSUANCE OF THIS REPORT IN A PRESS RELEASE?

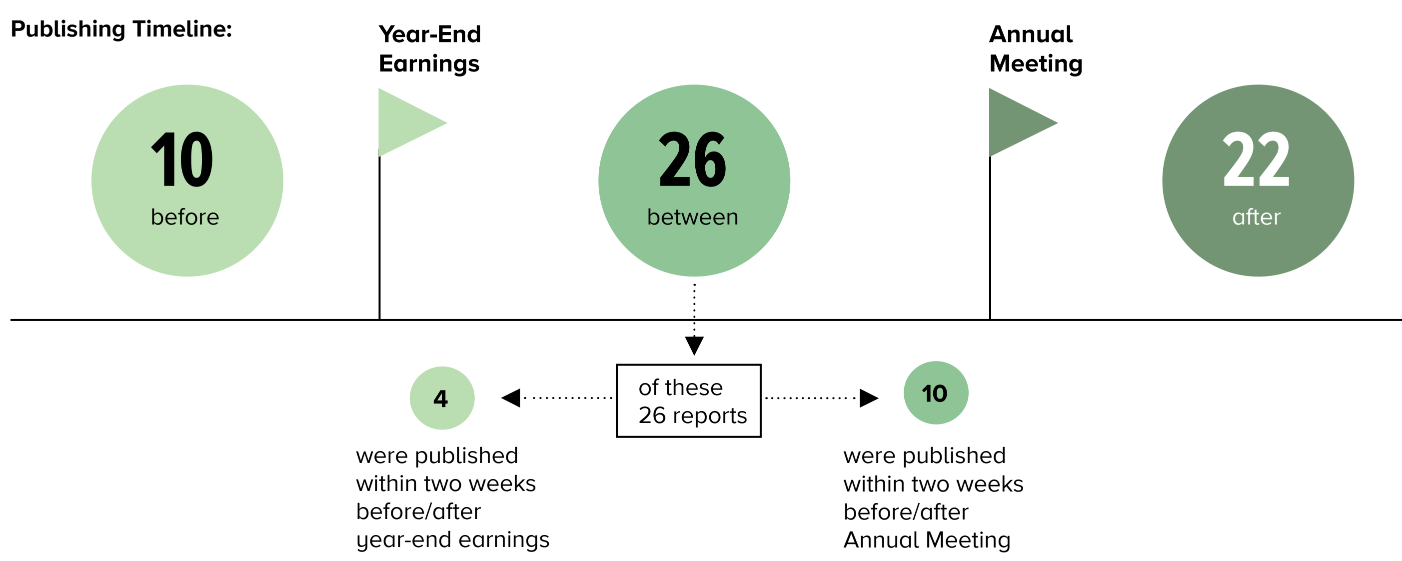


Of the 58 Top 100 Companies for which it could be determined when they issued their main CSR Report,

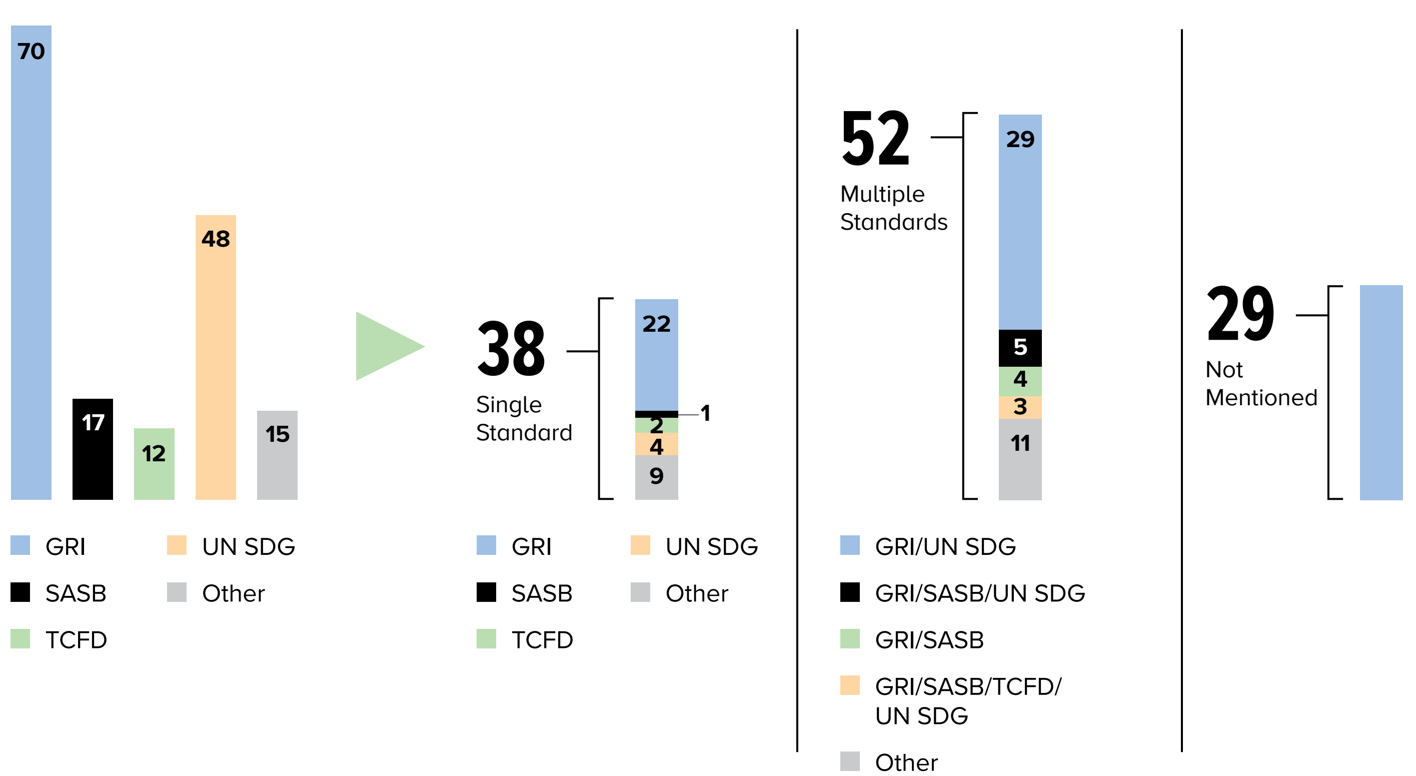
36 issued their reports prior to their annual meeting, and

22 issued their reports after their annual meeting

WHEN IS THIS REPORT MADE PUBLIC?

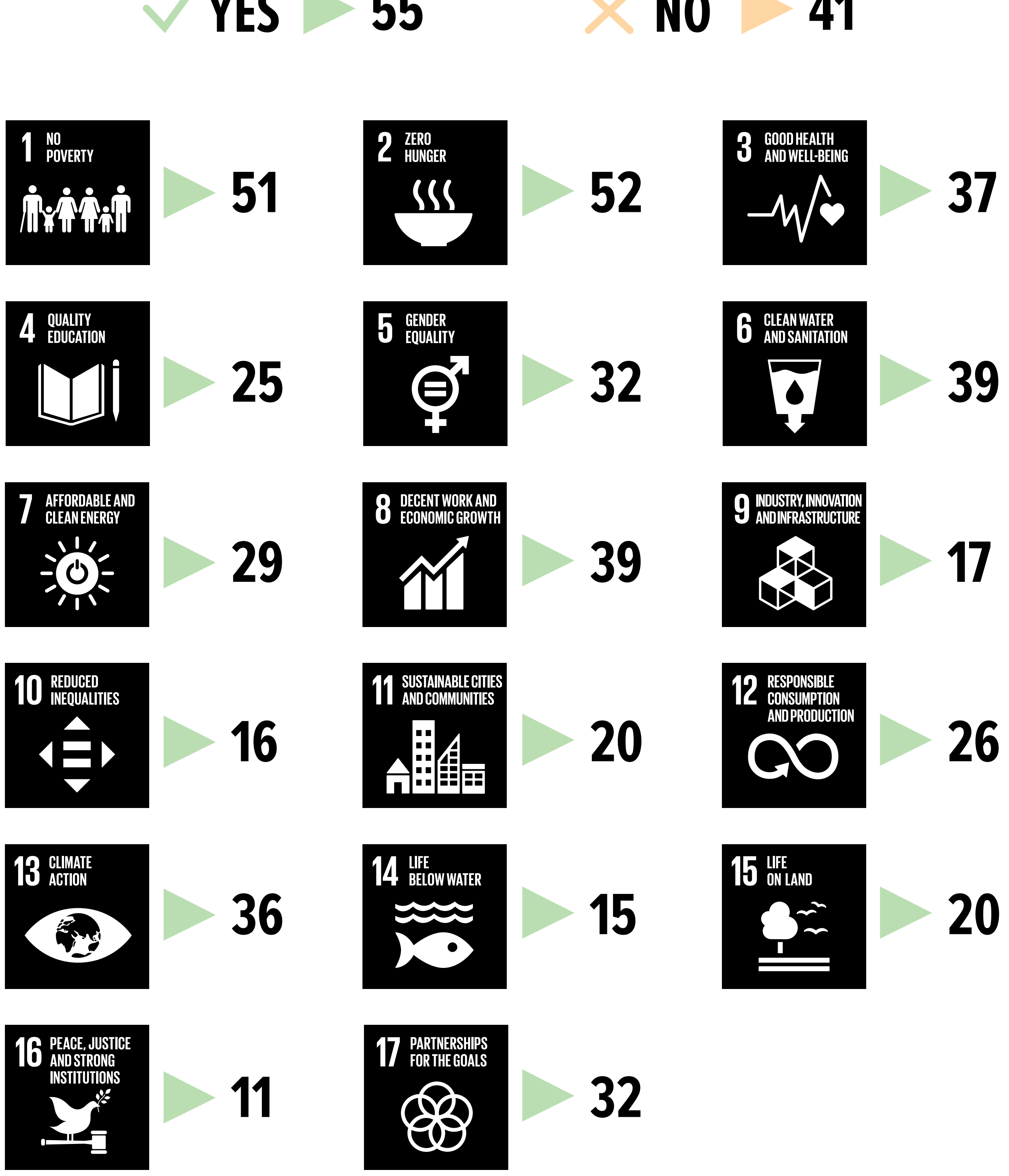


WHAT STANDARDS DID THE COMPANY REFERENCE IN PREPARING ITS MAIN CSR REPORT?

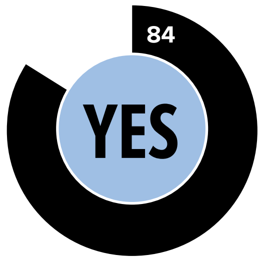


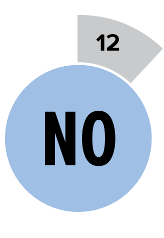
DOES THE COMPANY DISCLOSE ITS ALIGNMENT WITH THE UNITED NATION'S SUSTAINABLE DEVELOPMENT GOALS (SDGs)?

YES ▶ 55 NO ▶ 41

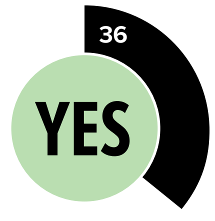


DOES THE CSR REPORT CONTAIN A LETTER FROM THEIR CEO?



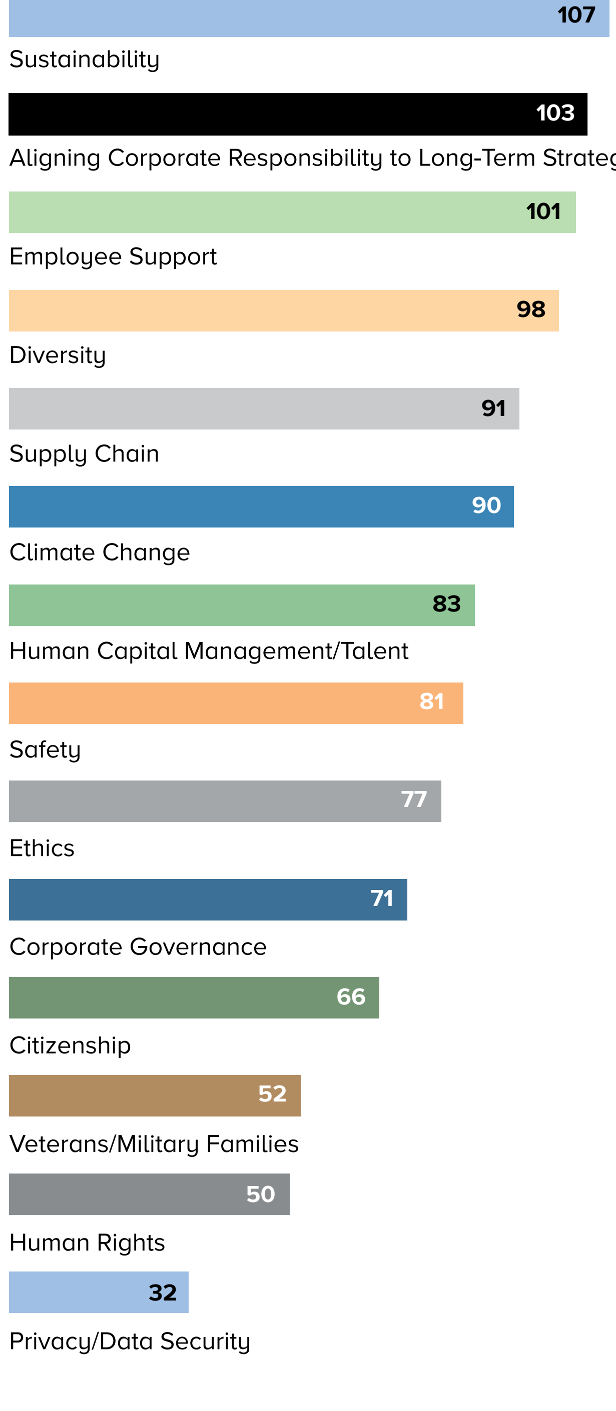


DOES THE COMPANY HAVE A "CHIEF SUSTAINABILITY OFFICER" (OR OTHER OFFICER WITH A SIMILAR TITLE)?

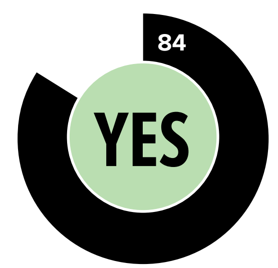


THERE WAS A REASONABLE DEGREE OF CONSISTENCY IN THE TOPICS COVERED IN THE 2019 CSR REPORTS OF THE TOP 100 COMPANIES

WHAT TOPICS ARE COVERED IN THE REPORT?

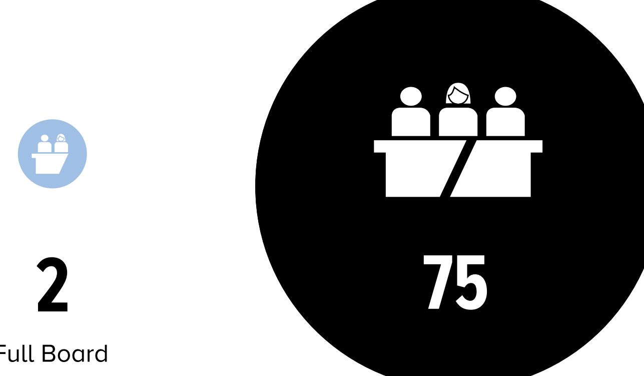


DOES THE COMPANY DISCLOSE ITS BOARD'S OVERSIGHT OF ESG MATTERS IN ITS PROXY STATEMENT?



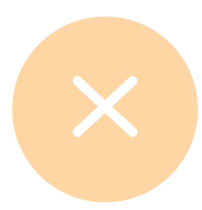
HOW DOES THE BOARD ALLOCATE RESPONSIBILITY FOR ESG OVERSIGHT?

2
Full Board



Board and Committee

7
Committee Only



16
Not Disclosed

COMMITTEES RESPONSIBLE FOR ESG OVERSIGHT**

53
Nominating and Governance Committee

32
Public Policy/Regulatory and Compliance/Sustainability Committee

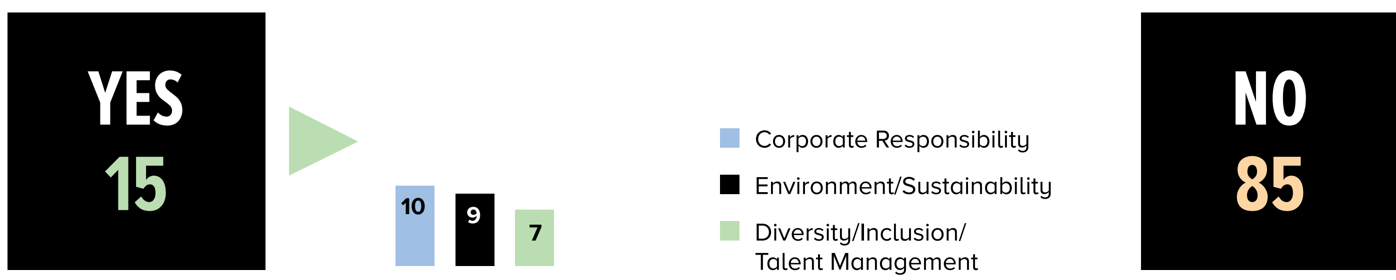
5
Audit Committee

4
Compensation Committee

** Based on a review of proxy statements, committee charters and corporate governance guidelines; of the 82 of the Top 100 Companies that disclosed which board committee(s) had responsibility for ESG oversight, nine of the Top 100 Companies had two or more committees responsible for such oversight.

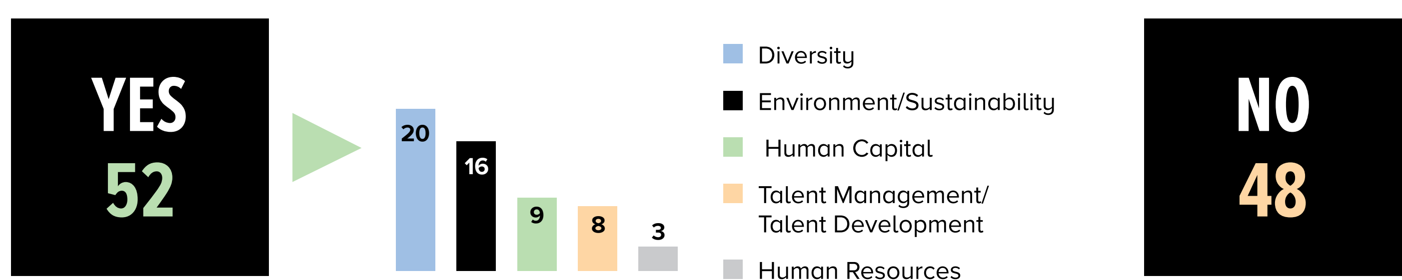
IS ESG OVERSIGHT DISCLOSED IN COMMITTEE CHARTERS OR CORPORATE GOVERNANCE GUIDELINES?

ARE ESG FACTORS CONSIDERED IN LONG- OR SHORT-TERM COMPENSATION METRICS?***



*** Some companies considered more than one ESG factor in their short- or long-term compensation metrics.

DOES THE PROXY STATEMENT IDENTIFY ESG FACTORS AS A SKILL SET IN THE DIRECTOR SKILLS MATRIX OR NARRATIVE DESCRIPTION?****



**** Some companies included more than one ESG factor as a skill set in their director skills matrix or narrative description.

DATA

DIRECTOR SKILL SET

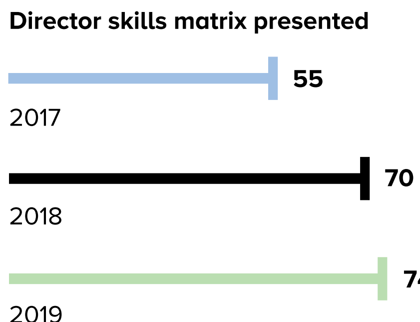
Inclusion of a director skills matrix and information about director diversity in the proxy statements of the Top 100 Companies continued to increase in 2019.

DIRECTOR SKILLS MATRIX

One of many initiatives to encourage large public companies to promote diversity on public company boards involves, among other things, asking public companies to add a director skills matrix as part of their proxy statement disclosures.

This effort was spearheaded by the New York City Comptroller in its 2017 Board Accessibility Project. Since 2017, the use of the skills matrix has increased.

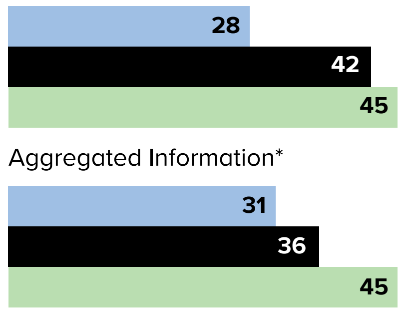
Director skills matrix presented



Companies vary considerably in how they present the experience, qualifications, attributes and skills of directors in the matrix. The information may be presented in the aggregate or identify specific directors who have such experience, qualifications, attributes and skills.

BOARD SKILLS INFORMATION

SEC rules require companies to disclose the "experience, qualifications, attributes and skills that led to the conclusion that the person should serve as a director for the registrant at the time the disclosure is made, in light of the registrant's business and structure." As a result of this disclosure requirement, companies typically discuss director experience, qualifications, attributes and skills as part of each director's biography. There is a movement toward presenting this information in a matrix format so that shareholders can have a picture of the experience, qualifications, attributes and skills of the board as a whole.



2017 2018 2019

Presentation of Skill Matrix

* Some companies included both aggregated information and individual director information in their director skills matrix.

DATA

BOARD DIVERSITY

Board diversity disclosures continued to increase in 2019 with more companies presenting this data on an aggregated basis.

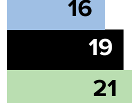
Companies vary considerably in how they present information regarding board diversity in their proxy statements. In 2019, the number of Top 100 Companies that presented information about the diversity of their boards on an aggregated basis, as opposed to presenting director-specific information, increased from 53 companies in 2017 to 70 companies in 2018 and 77 companies in 2019.

	2017	2018	2019
Aggregated diversity information for all directors*	53	70	77
Director-specific diversity information presented*	46	46	25
No board diversity information presented	26	18	20

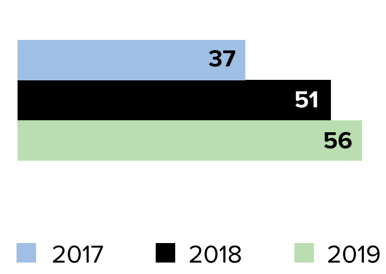
* Includes companies that presented both aggregated and director-specific diversity information.

Where aggregated diversity information for the board was presented (77 of the Top 100 Companies in 2019), 56 of these companies presented separate categories of diversity as opposed to aggregating under a single "diversity" heading.

Presented aggregated diversity information



Presented diversity information in separate categories



2017 2018 2019

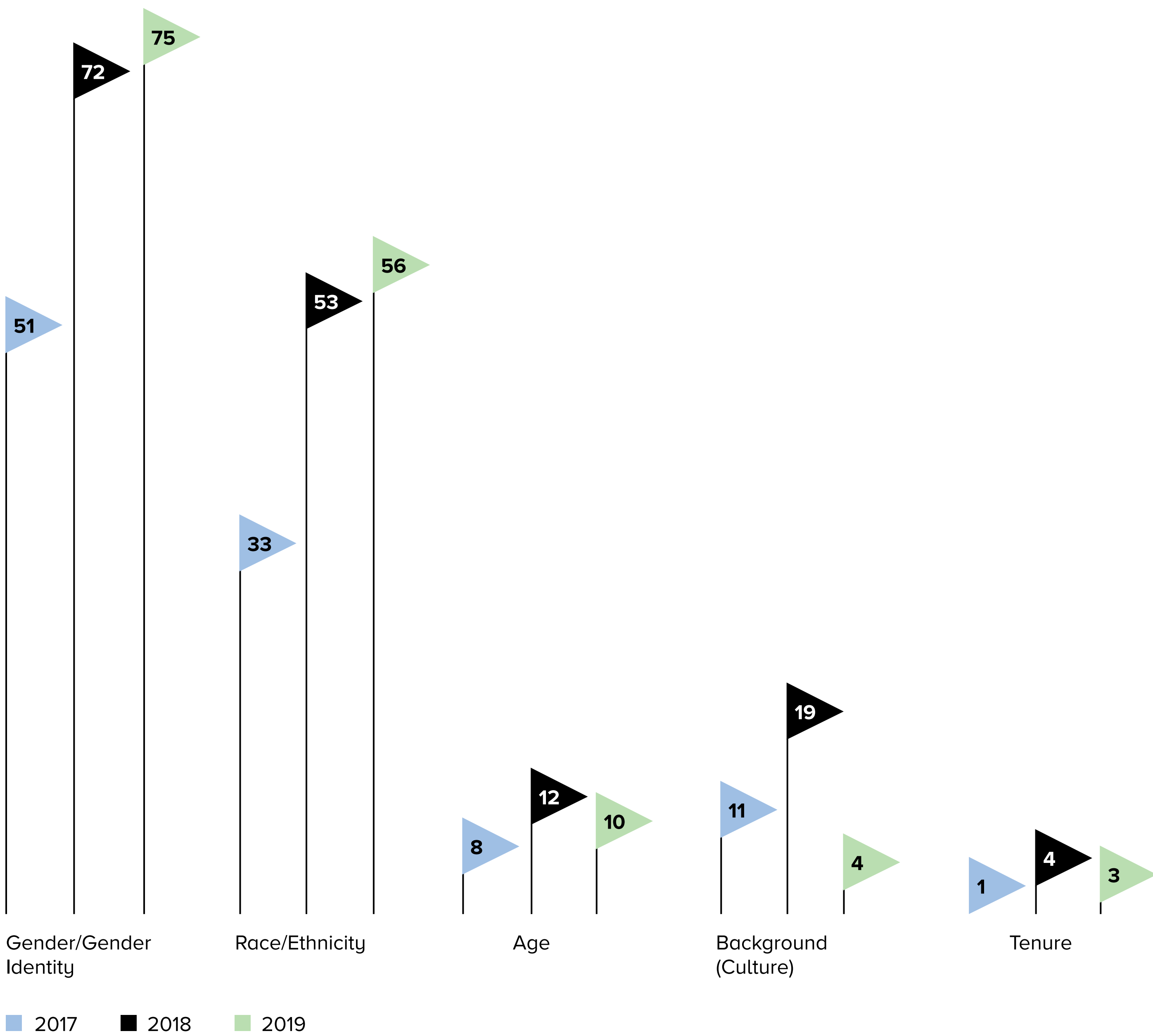
DIRECTOR PHOTOS

A majority of the Top 100 Companies included director photos in their proxy statements:

79

21

The most commonly identified categories of board diversity continue to be gender/gender identity and race/ethnicity, which increased from 51 and 33 companies, respectively, in 2017 to 72 and 53 companies, respectively, in 2018 and 75 and 56 companies, respectively, in 2019. Various other categories that were presented included age, the cultural background of directors, such as national origin, citizenship and place of birth and tenure.



DATA

PROXY ACCESS

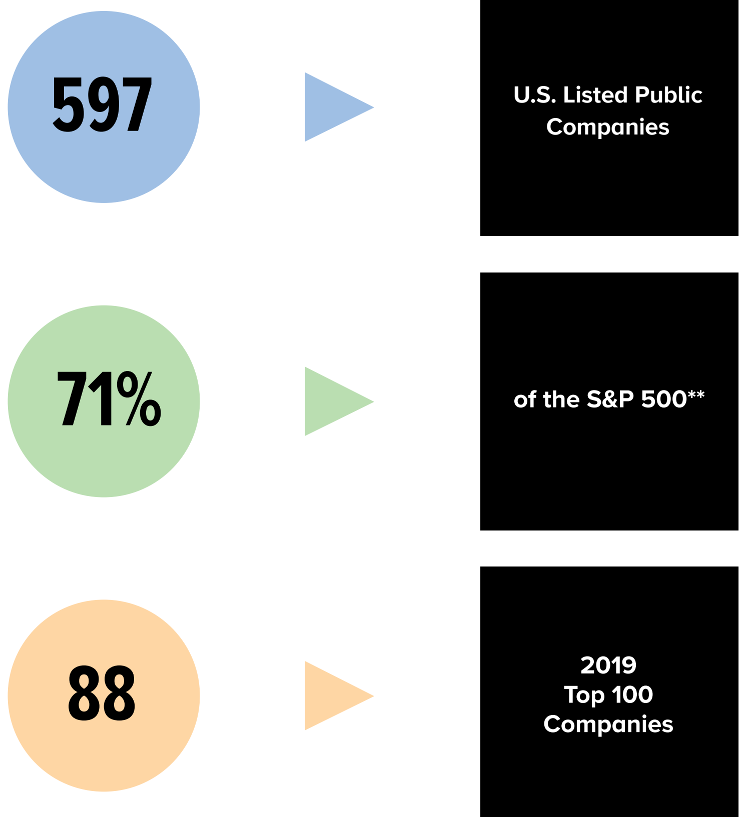
While proxy access adoption among the S&P 500 is now in excess of 70%, the adoption rate for the Russell 3000 is still only around 20%. Proxy access has transitioned from a “hot topic” to a steady state topic as the headline terms of proxy access bylaws have largely become standardized and shareholder proposal activity has decreased.

PROXY ACCESS ADOPTION

* Excludes companies that received an “adopt” proposal and were acquired or filed for bankruptcy before adopting (12 companies) or had such a proposal receive a passing vote in favor in 2019 but have not yet adopted a proxy access bylaw (three companies).

All proxy access data is for all U.S. listed public companies and is as of June 30, 2019, unless otherwise noted.

NUMBER OF COMPANIES THAT HAVE ADOPTED PROXY ACCESS



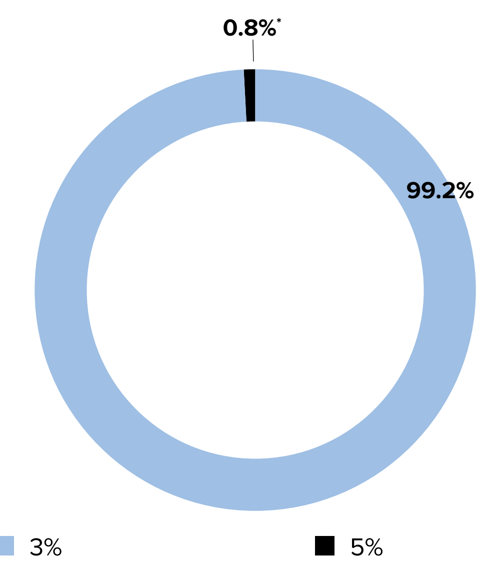
PROXY ACCESS PREVALENCE CONTINUED TO INCREASE IN 2019, ALTHOUGH AT A SLOWER RATE

**S&P 500 companies are as of 2019.

HEADLINE TERMS OF PROXY ACCESS BYLAWS

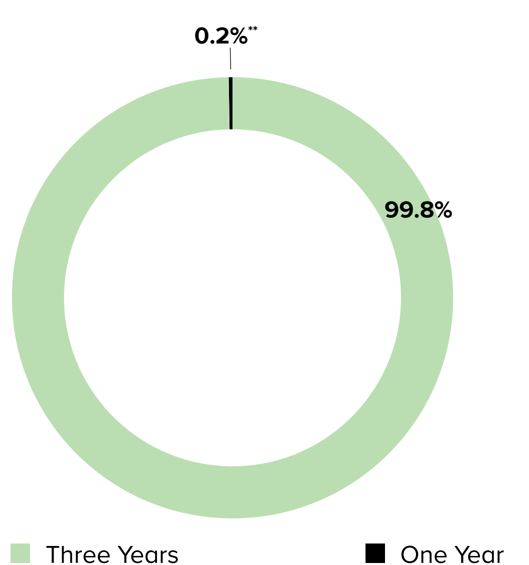
The most common formulation of the headline terms permits shareholders owning at least 3% of company stock for at least three years to submit proxy access nominees up to a maximum of 20% of the board / minimum of two directors with up to 20 shareholders being able to aggregate their holdings to meet the minimum ownership requirements. The shorthand for proxy access bylaws with this formulation is 3/3/20/20.

Minimum ownership amount (%)



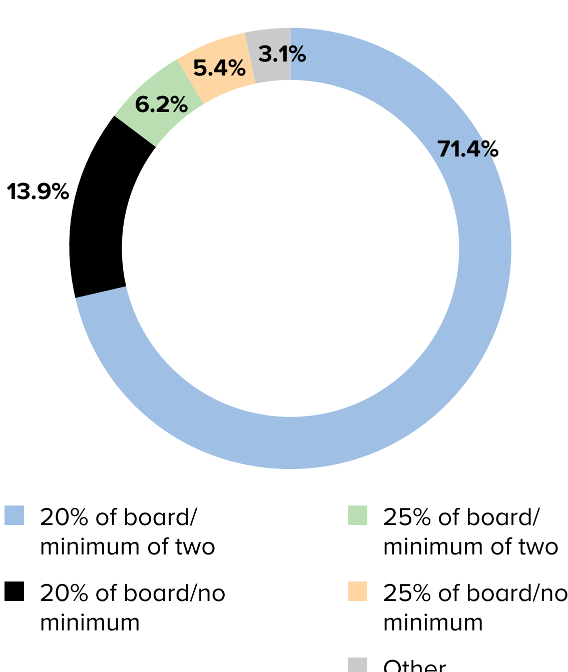
* Four companies have 5% minimum ownership thresholds.

Minimum period as shareholder (in # of years)

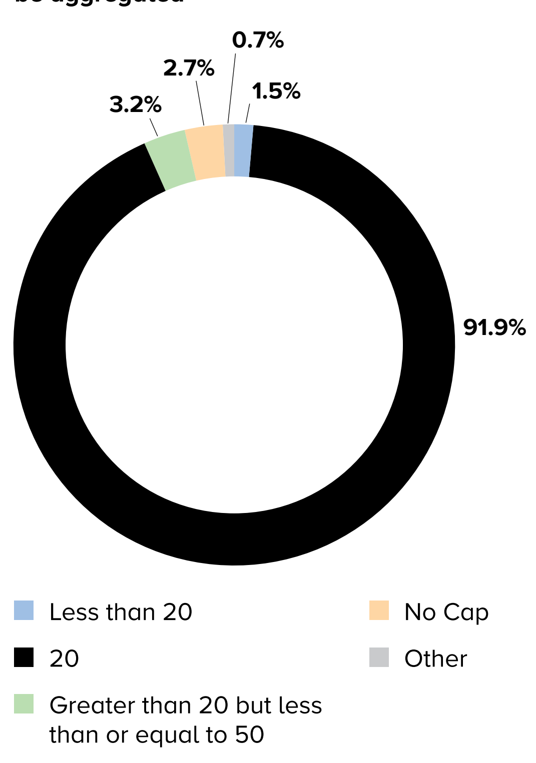


** One company has a one-year minimum holding period.

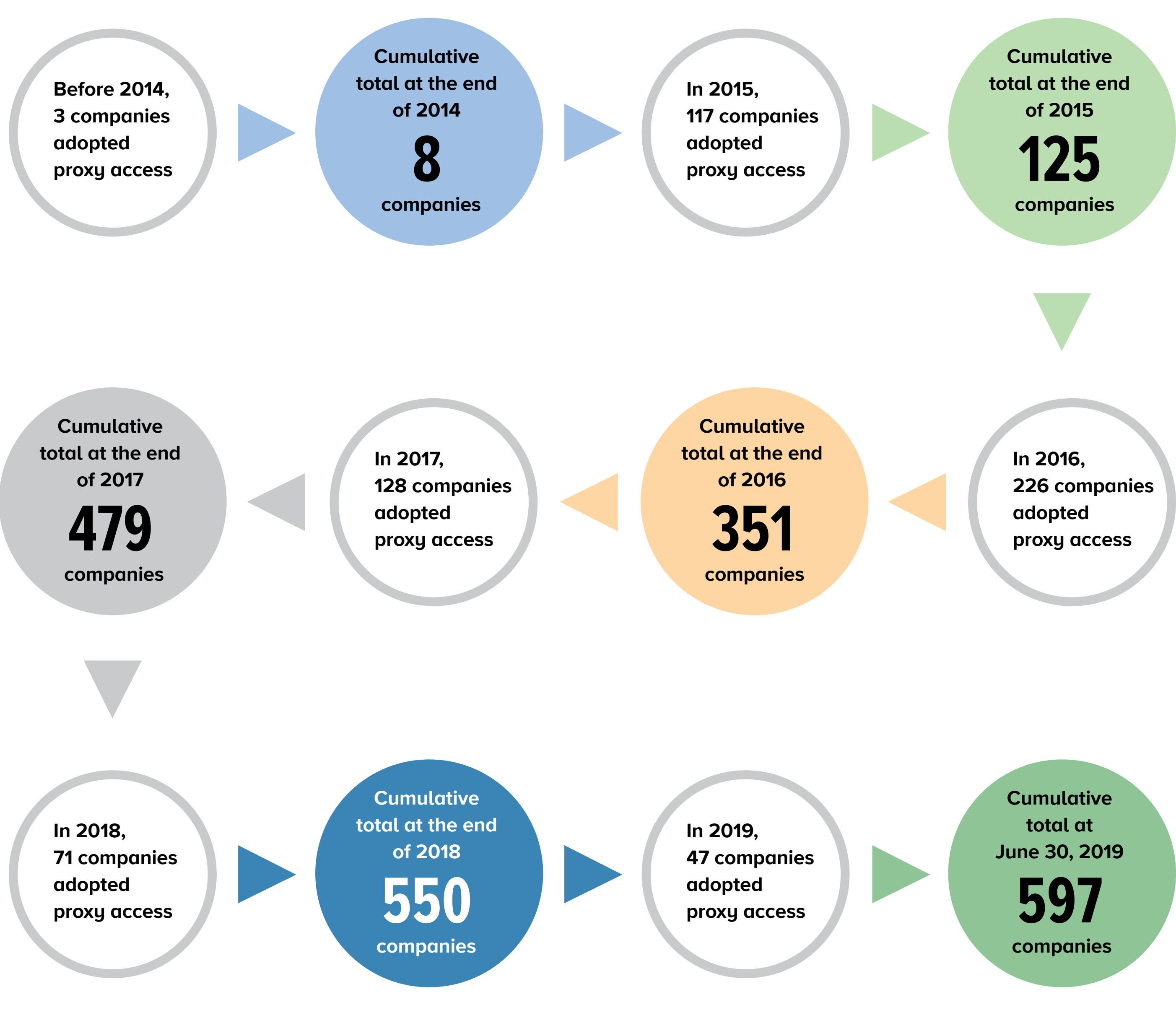
Maximum percentage of board / minimum number of directors



Maximum number of shareholders that can be aggregated



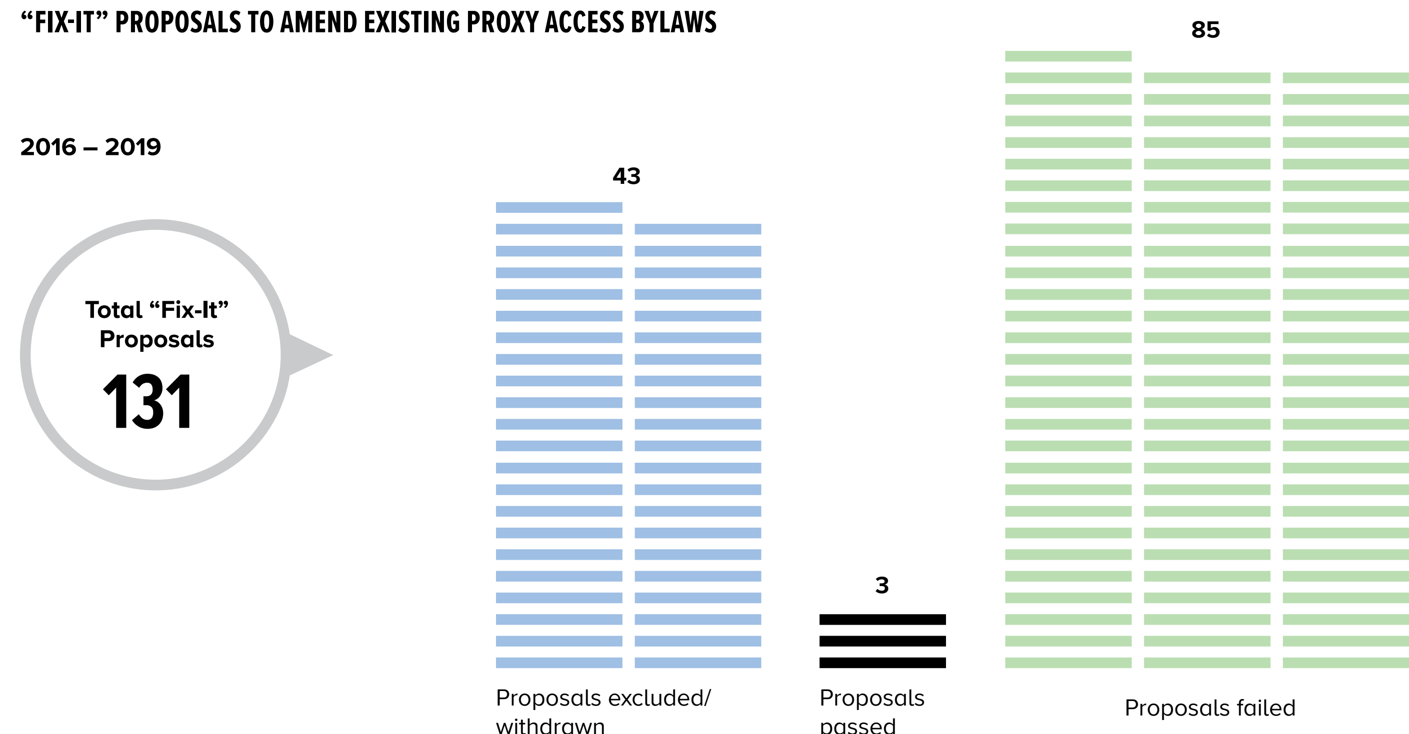
PROXY ACCESS ADOPTION OVER TIME

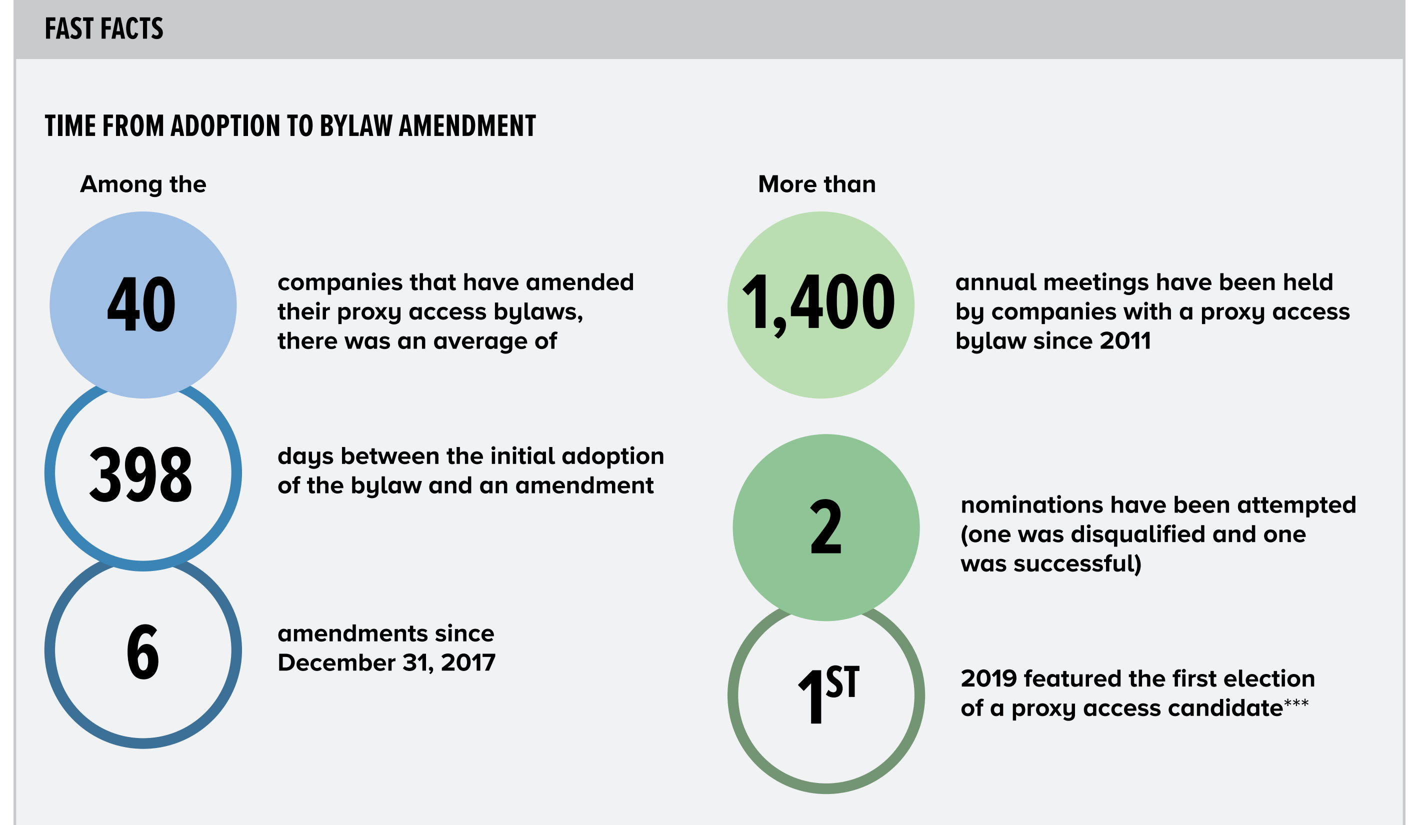


SHAREHOLDER PROPOSALS FOR ADOPTION OF PROXY ACCESS

Year	Proposals Voted On	Outcome	Average vote in favor
2015	91 Proposals Voted On (60% Pass Rate)	55 Proposals Passed	60% Average vote in favor
		36 Proposals Failed	40% Average vote in favor
2016	76 Proposals Voted On (53% Pass Rate)	40 Proposals Passed	68% Average vote in favor
		36 Proposals Failed	31% Average vote in favor
2017	29 Proposals Voted On (62% Pass Rate)	18 Proposals Passed	72% Average vote in favor
		11 Proposals Failed	30% Average vote in favor
2018	13 Proposals Voted On (31% Pass Rate)	4 Proposals Passed	73% Average vote in favor
		9 Proposals Failed	28% Average vote in favor
2019	7 Proposals Voted On (57% Pass Rate)	4 Proposals Passed	79% Average vote in favor
		3 Proposals Failed	34% Average vote in favor

“FIX-IT” PROPOSALS TO AMEND EXISTING PROXY ACCESS BYLAWS





*** Glenn J. Krevlin was elected to the Board of Directors of The Joint Corp.

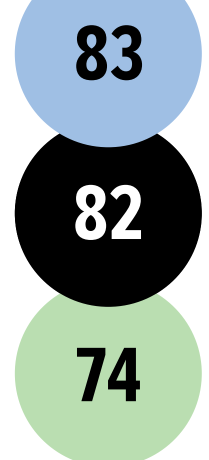
DATA

ADDITIONAL PROXY STATEMENT DISCLOSURES

Voluntary proxy statement disclosures by the Top 100 Companies, relating to topics such as shareholder engagement and the board self-evaluation process, continued to increase in 2019.

SHAREHOLDER ENGAGEMENT DISCLOSURES

Proxy statements frequently include a section that summarizes a company's approach to shareholder engagement.

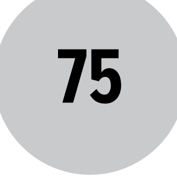


83 of the Top 100 Companies made shareholder engagement disclosures in their 2019 proxy statements, nearly even with

82 in 2018, and up from

74 in 2017

Although SEC rules do not mandate disclosure on the board's self-evaluation process, 75 of the Top 100 Companies include such disclosure in their proxy statements.

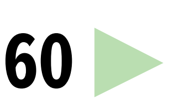


Board Self-Evaluation Process Disclosure

ADDITIONAL PROXY STATEMENT DISCLOSURES

Letters to Shareholders*

51 of the Top 100 Companies included a letter from their CEO with their proxy statement



60 of the Top 100 Companies included a letter from their board chair or lead independent director with their proxy statement

* Some companies included in their proxy statements one or more letters in each of the above categories or a joint letter from a person in each of the above categories; joint letters are included in both of the above categories.

Summaries

Companies may include summary sections (frequently in the front of the proxy statement) to briefly highlight an area discussed in greater depth later in the document.

85 of the Top 100 Companies included a proxy statement summary

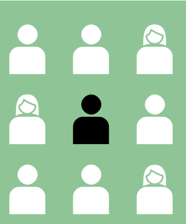
80 of the Top 100 Companies included a corporate governance highlights section

78 of the Top 100 Companies included an executive compensation highlights section

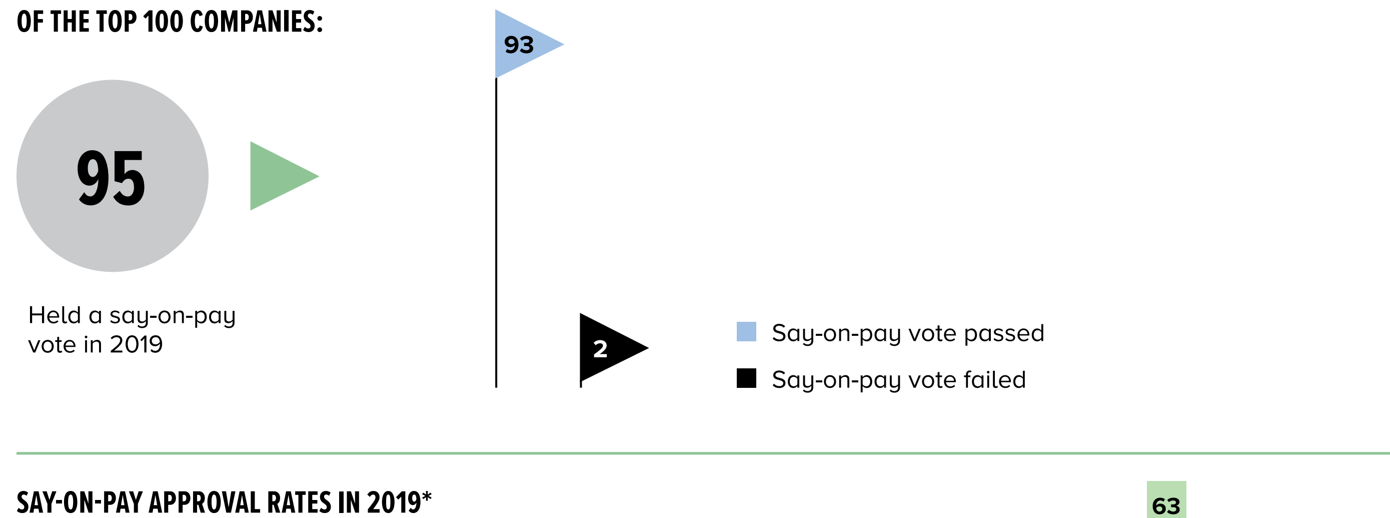
DATA

SAY-ON-PAY

2019 represented the eighth proxy season under the Dodd-Frank Act's mandatory say-on-pay regime. As shown below, during the past three years, there has been a shift in say-on-pay approval rates from the more than 95% category to the 90%–95% category.

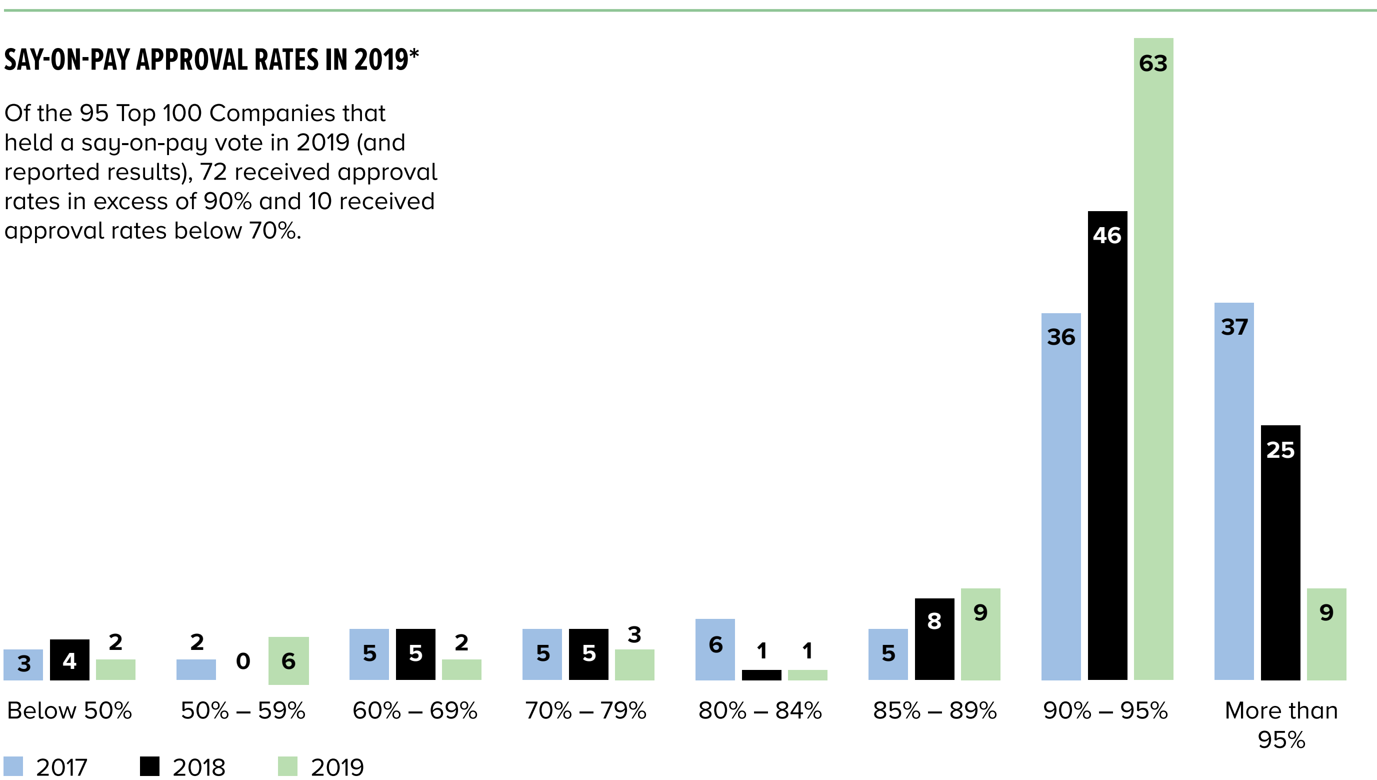


OF THE TOP 100 COMPANIES:



SAY-ON-PAY APPROVAL RATES IN 2019*

Of the 95 Top 100 Companies that held a say-on-pay vote in 2019 (and reported results), 72 received approval rates in excess of 90% and 10 received approval rates below 70%.



* Approval rates are calculated on the ratio of votes "for" over the sum of votes cast plus abstentions, as reported in SEC filings. Ranges include fractional percentages, so, for example, the range of 50%–59% includes all voting results from 50.00% to 59.99%.

CLAWBACK POLICIES

Although rules implementing Section 954 of the Dodd-Frank Act have yet to be finalized, many of the Top 100 Companies voluntarily maintain clawback policies. Proxy advisory groups strongly encourage public companies to adopt clawback policies as an element of sound corporate governance and risk mitigation. Issuer policies, however, are not uniform.

TRIGGERS

The Dodd-Frank Act requires recoupment of compensation upon an accounting restatement due to material noncompliance with any financial reporting requirements. The SEC's proposed rules interpret material noncompliance to mean any error that is material to previously filed financial statements. The restatement need not result from fraud or misconduct by the issuer or any of its employees.

Triggers at the Top 100 Companies include:*

45 require fraud or misconduct related to the financial restatement

40 do not require fraud or misconduct

85 Financial restatement

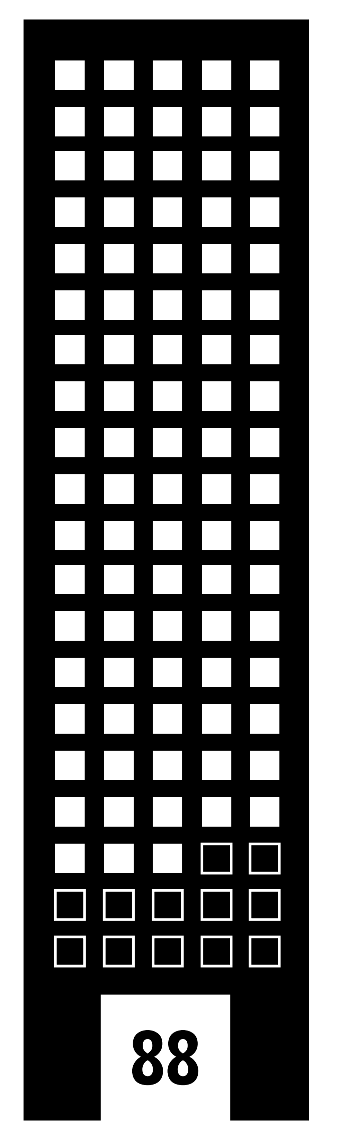
11 Fraud or misconduct relating to financial statements (no restatement required)

8 Materially inaccurate financial statements (no restatement required)

4 Compliant with proposed rule

43 Employee subject to the recoupment engaged in fraud or misconduct

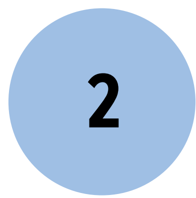
* The policies at 26 of the Top 100 Companies use multiple triggering events.



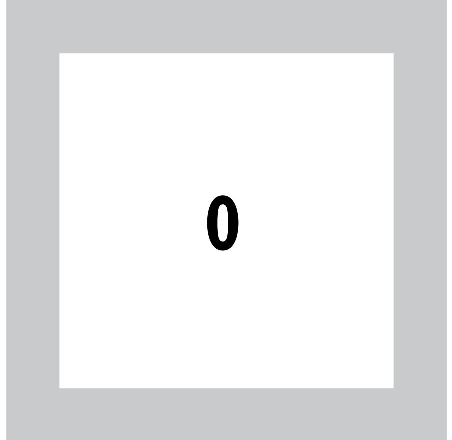
of the Top 100 Companies expressly disclose that they maintain a financial-related clawback policy

COVERED PERSONS

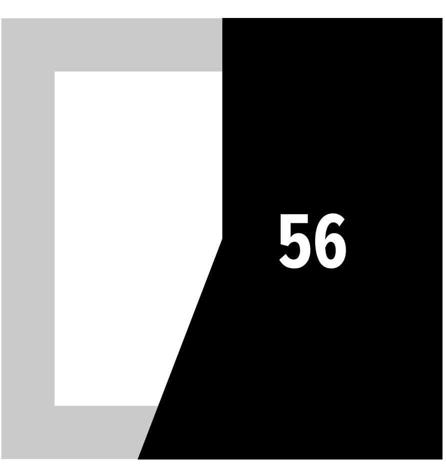
The threshold issue is determining whose compensation is subject to a clawback. Clawbacks mandated under the proposed SEC rule will apply to all current and former Section 16 officers. The following individuals are subject to the voluntary financial-related clawbacks at the Top 100 Companies:



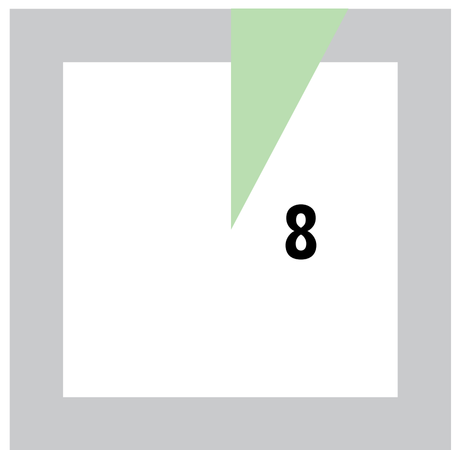
of the Top 100 Companies expressly disclose that the clawback policy applies to former employees or executives



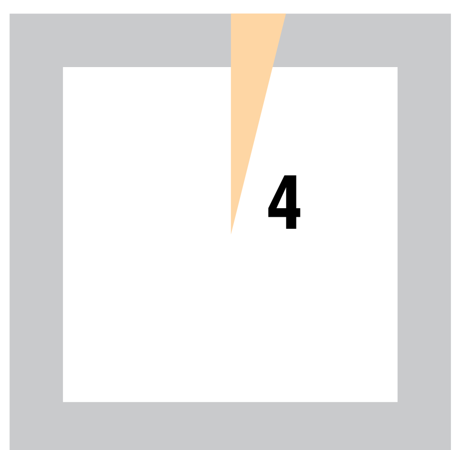
Named Executive Officers (NEOs) Only



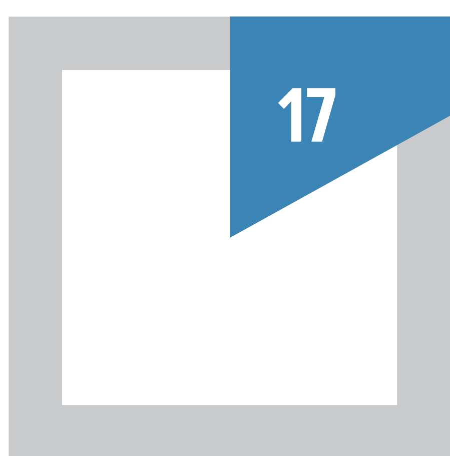
All Executive Officers



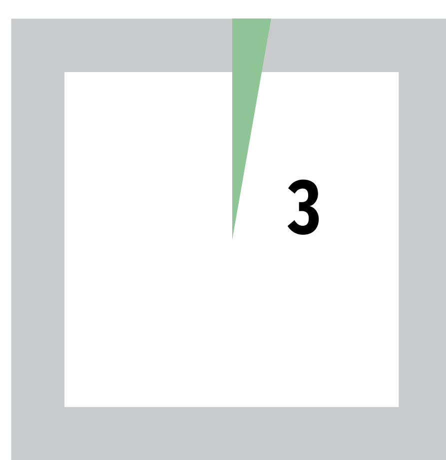
Senior Employees



All Officers



All Employees (or all participants in the plans or programs subject to the clawback policy)



Not Disclosed

COMPENSATION SUBJECT TO CLAWBACK

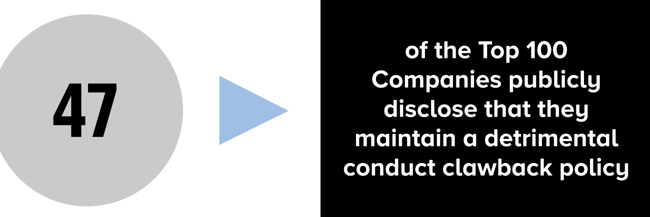
The Dodd-Frank Act compliant clawback policies will require companies to recover "certain incentive-based compensation (including stock options)." The SEC's proposed rules define incentive-based compensation as including both cash and equity compensation, but time-vested awards are not covered. While voluntary clawback policies generally permit a company to recoup "incentive compensation," the forms of incentive compensation that may be recouped vary.

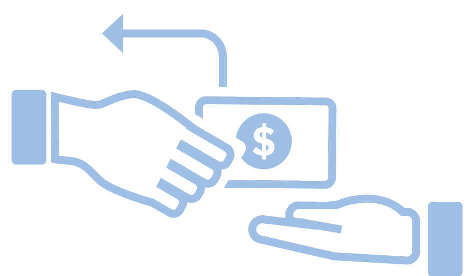
Of the 88 Top 100 Companies that maintain a clawback policy, they may recoup:

Category	Number
Both cash and equity	73
Cash only	4
Equity only	6
Not specified	5

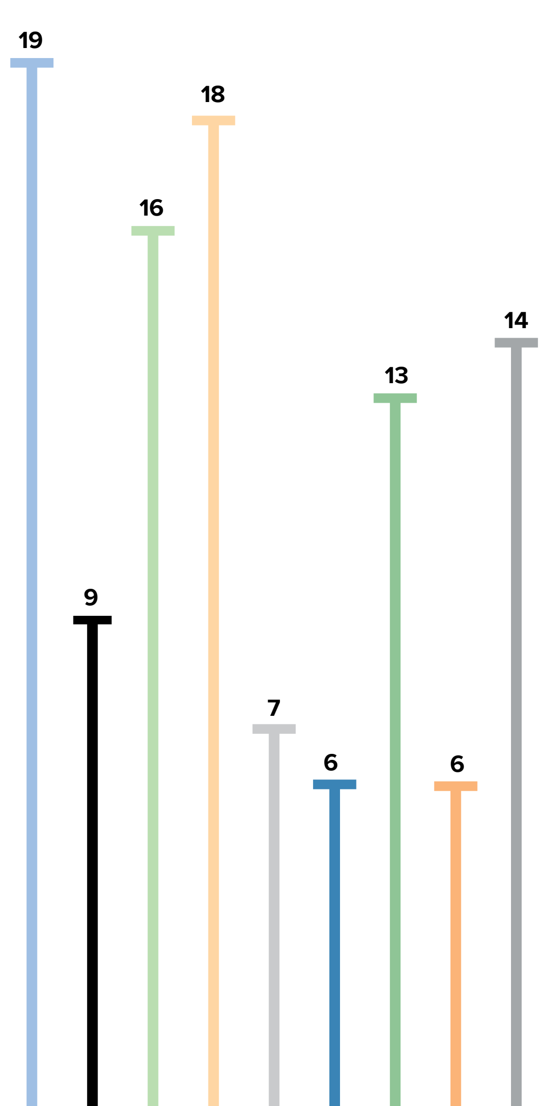
Of the 88 Top 100 Companies that maintain a clawback policy:

Category	Number
Retain discretion as to whether to seek enforcement	58
Appear to provide for mandatory enforcement	12
Provide for both mandatory and discretionary enforcement, depending on the triggering event	7
Not specified	11





Common triggering events for the policies at the Top 100 Companies include:



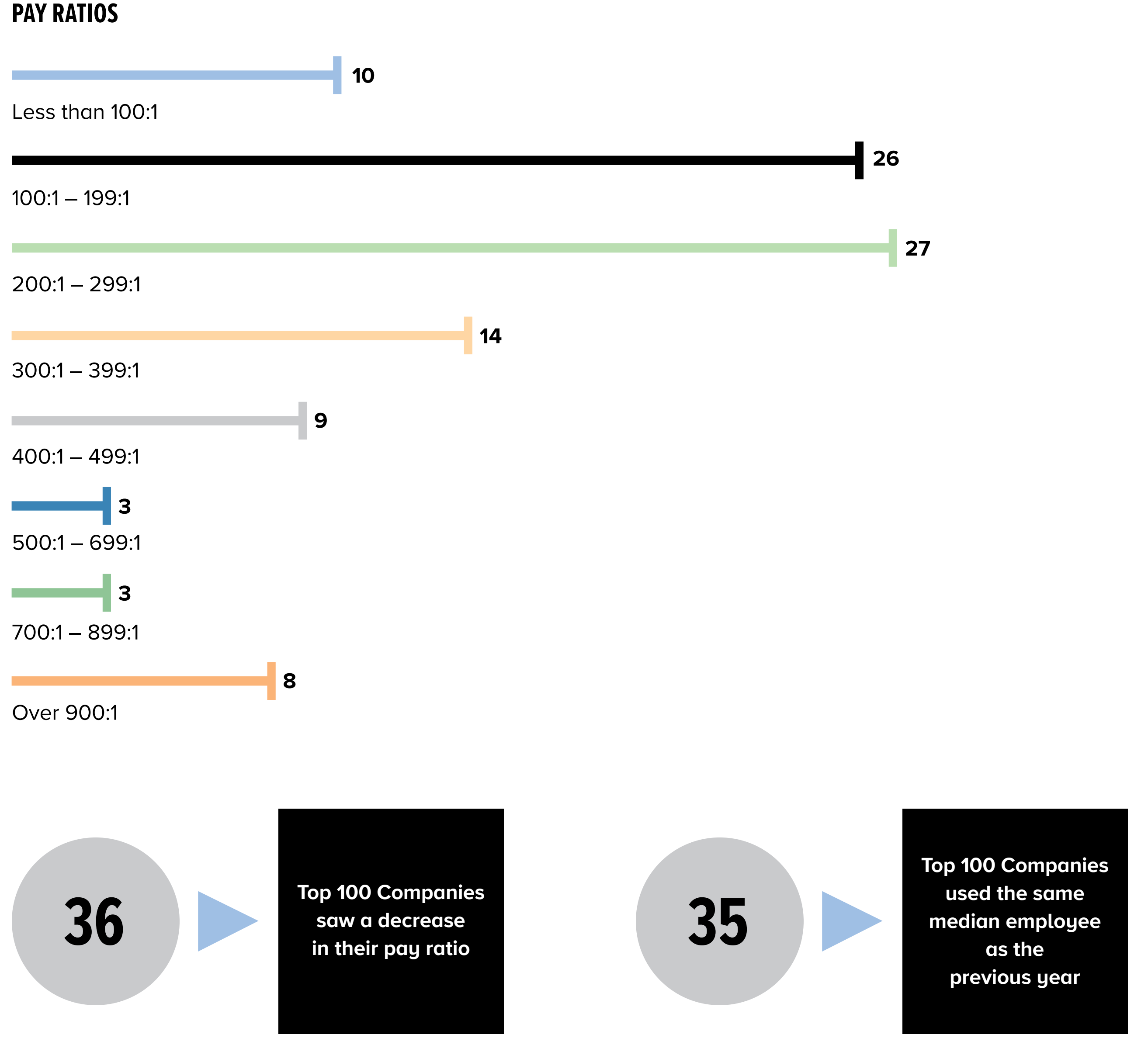
- Violation of restrictive covenants (e.g., noncompetes, nonsolicitation and confidentiality agreements)
- Violation of law (including embezzlement, theft and bribery)
- Violation of company policy (including code of conduct and code of ethics)
- Acts resulting in reputational, financial or other harm to the company
- Failure of risk management
- Failure to supervise
- General fraud or misconduct
- Termination for cause or misconduct
- Other detrimental activities

DATA

CEO PAY RATIO

2019 represented the second proxy season that companies were required to disclose the ratio of CEO pay to pay of the median employee. For 18 of the Top 100 Companies, 2019 was the first proxy season for which disclosure was required.

PAY RATIOS



DATA

HEDGING AND PLEDGING POLICIES

90
of the Top 100 Companies maintain pledging policies

96
of the Top 100 Companies maintain hedging policies

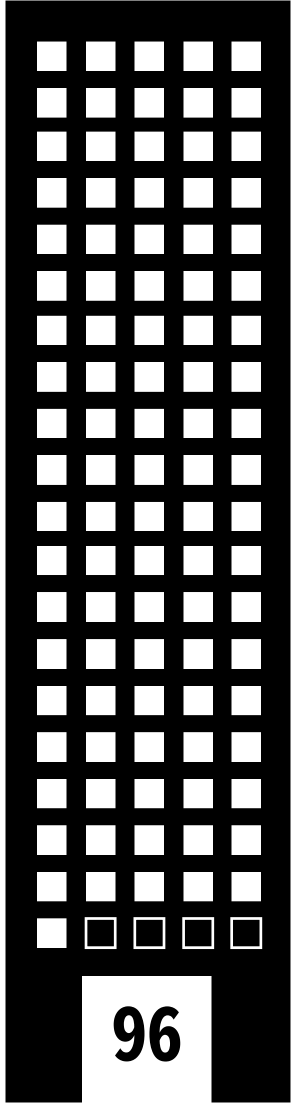
WHAT ARE THE TERMS OF THE PLEDGING POLICY?

* Two of the Top 100 Companies provide for an outright prohibition other than in limited circumstances.

DODD-FRANK HEDGING DISCLOSURE RULES IN EFFECT

Pursuant to final rules promulgated under the Dodd-Frank Act, issuers other than smaller reporting companies and emerging growth companies must include disclosure about their hedging policies in proxy and information statements with respect to the election of directors during fiscal years beginning on or after July 1, 2019. For smaller reporting companies and emerging growth companies, compliance is required for fiscal years beginning on or after July 1, 2020. If an issuer does not have a hedging policy, that fact must also be disclosed.

WHAT ARE THE TERMS OF THE HEDGING POLICY?



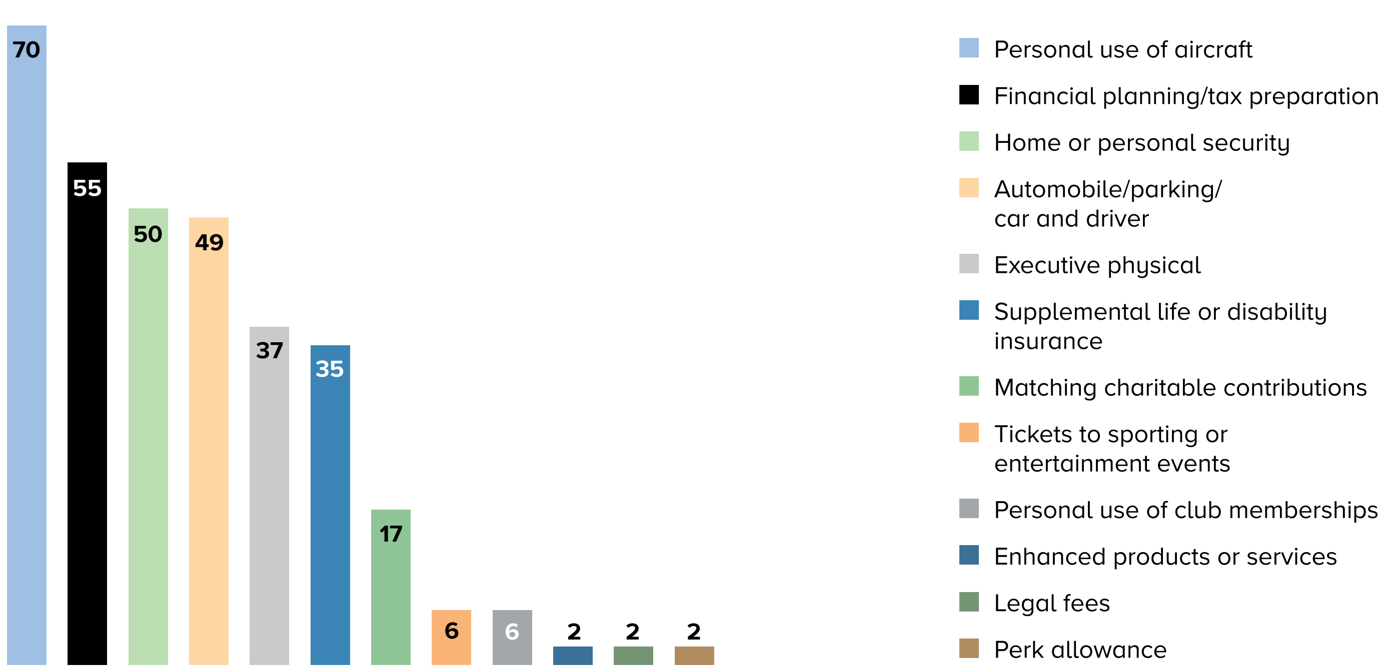
All 96 of the Top 100 Companies Prohibit Hedging Outright

DATA

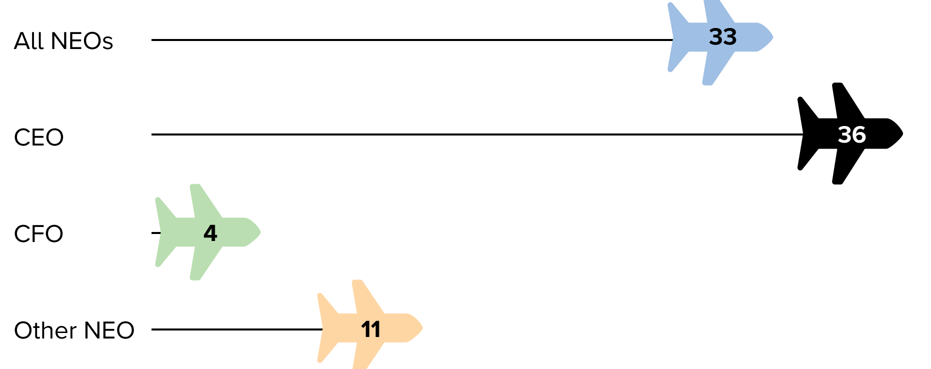
EXECUTIVE PERQUISITIES

95 of the Top 100 Companies provide executive perquisites

23 of the Top 100 Companies disclosed that they provide tax gross-ups on some or all perks provided to executives



WHO IS ENTITLED TO PERSONAL USE OF CORPORATE AIRCRAFT?



- 18 of the Top 100 Companies required executives to reimburse the company for all or a portion of their personal aircraft usage
- In many instances, personal usage is limited to availability and requires approval by the CEO

DATA

GOLDEN PARACHUTE PROVISIONS

With the advent of say-on-pay and increased focus by institutional investors on executive compensation, golden parachute gross-up provisions have become all but obsolete at the Top 100 Companies. Increasingly, however, the Top 100 Companies are implementing reduction provisions intended to protect executives from the excise tax.

CHANGE IN CONTROL EXCISE TAX PROVISIONS

Description of Golden Parachute Provisions Under the Code

Section 4999 of the Internal Revenue Code (the "Code") imposes a 20% excise tax on the amount of any "excess parachute payments" received by certain executives, and Section 280G of the Code disallows an employer deduction for those payments. Any gross-up payment made in connection with the excise tax will also be subject to the excise tax and will be non-deductible. If the aggregate present value of all parachute payments paid to an executive (including cash and accelerated equity awards) equals or exceeds three times the executive's base amount, then the executive will be considered to have received an excess parachute payment.

Excess Parachute Payment

Code Sections 280G and 4999 are triggered if all parachute payments equal or exceed three times the executive's base amount. The amount of the excess parachute payment that is not deductible under Section 280G, and subject to the excise tax under Section 4999, is any payment in excess of one times the executive's base amount.

Safe Harbor

The safe harbor is three times the executive's base amount, less one dollar. Many companies use a 2.99 multiple in making their calculations to avoid an inadvertent trigger.

Base Amount

An executive's base amount is the average of his or her compensation from the employer that was includible in his or her gross income for the most recent five calendar years ended prior to the year in which the change in control occurs.

Excise Tax Reduction Provisions

Companies are increasingly adopting measures to protect executives from the excise tax without providing tax gross-ups. The two most common measures include a "cut-back" provision and a "better-of" provision.

"Cut-Back" Provisions

Under a "cut-back" provision, the change in control payments are automatically reduced to the safe harbor amount (or, in many instances, 2.99 times the base amount) so that no excise tax applies.

7 of the Top 100 Companies maintain a "cut-back" provision

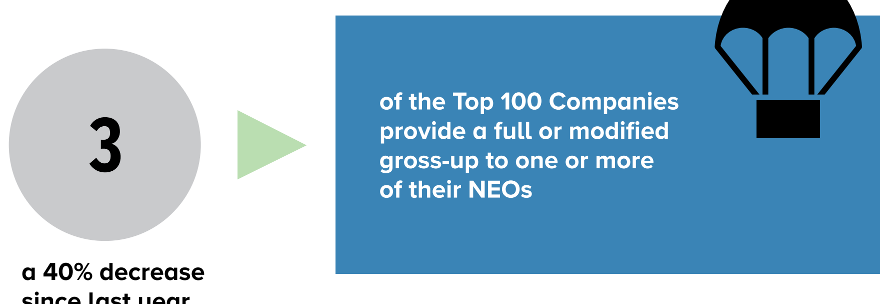
"Better-Of" Provisions

Under a "better-of" provision, employees will receive change in control payments equal to the greater of (1) the after-tax amount they would have received after the imposition of the Section 4999 excise tax and (2) the "cut-back" amount (i.e., the safe harbor).

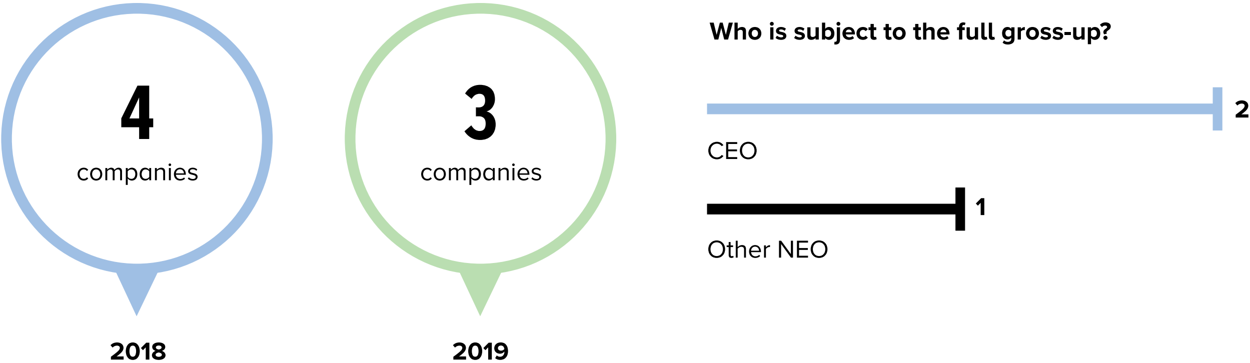
13 of the Top 100 Companies maintain a "better-of" provision

GOLDEN PARACHUTE EXCISE TAX GROSS-UPS

For the fifth year in a row, only a small number of companies provide some level of "golden parachute" excise tax gross-up protection.



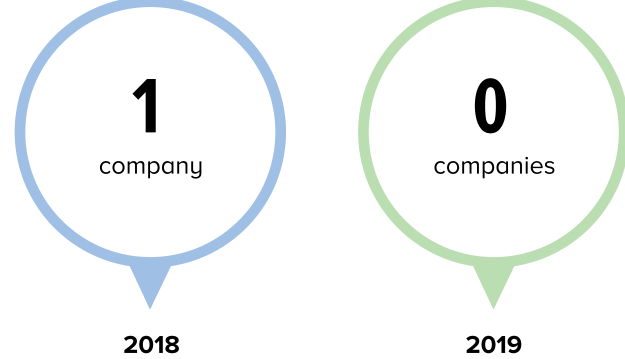
FULL GROSS-UPS



MODIFIED GROSS-UP

Under a modified gross-up, payment is only made if the change in control payments exceed a specified amount over the safe harbor. For instance, a company may provide that it will only pay a gross-up if the aggregate amount of the change in control payments exceeds the safe harbor amount, generally by 10% or more. At some companies, if the change in control payments are below this percentage, they will be cut back to the safe harbor amount.

This year, zero Top 100 Companies provide for a modified gross-up.



DATA

SURVEY METHODOLOGY

We reviewed the corporate governance and compensation practices of 100 of the largest U.S. public, non-controlled companies that have equity securities listed on the NYSE or Nasdaq. These companies were selected based on a combination of their latest annual revenues and market capitalizations and are referred to as the "Top 100 Companies." We derived the data in this Survey from publicly available sources described below, that were available as of June 1, 2019 (except where otherwise noted).

SHEARMAN & STERLING WOULD LIKE TO ACKNOWLEDGE THE FOLLOWING INDIVIDUALS FOR THEIR CONTRIBUTIONS TO THIS SURVEY:

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Jane Collins
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Margaret Eleazar-Smith
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Alex Freund
Lev Gaft
Jai Garg
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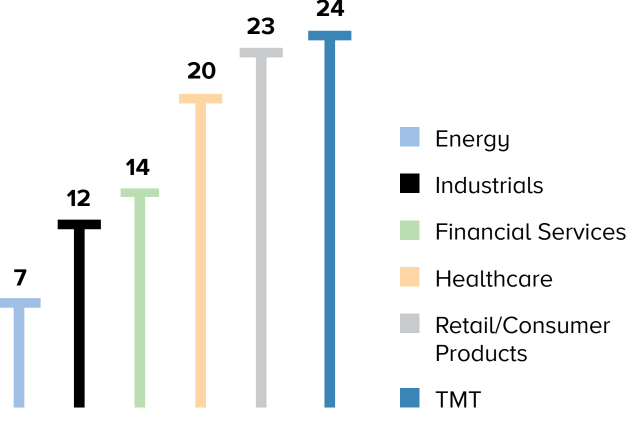
Elena Rodriguez
Taina Rosa
Ignacio Saldana
Frederick Shanks
Jake Shaughnessy
Manonh L. Soumahoro
Anna Stillman
Stella Sun
Vivian Sy
Wilfredo Tirado
Fatou Waggeh
Kevin Wu

INDUSTRIES OF SURVEYED COMPANIES:



SURVEYED DOCUMENTS:

- **Annual Proxy Statements**
- **Company Charters and Bylaws**
- **Board Committee Charters**
- **Corporate Governance Guidelines**
- **Corporate Social Responsibility Reports and Websites**

TOP 100 COMPANIES INCLUDED IN THE 2019 SURVEY:

3M Company
Abbott Laboratories
AbbVie Inc.
Adobe Inc.
Alphabet Inc.
Altria Group, Inc.
Amazon.com, Inc.
American Express Company
American International Group, Inc.
American Tower Corporation
AmerisourceBergen Corporation
Amgen Inc.
Anthem, Inc.
Apple Inc.
Archer-Daniels-Midland Company
AT&T Inc.
Bank of America Corporation
Berkshire Hathaway Inc.
The Boeing Company
Booking Holdings Inc.
Bristol-Myers Squibb Company
Broadcom Inc.
Cardinal Health, Inc.
Caterpillar Inc.
Charter Communications, Inc.
Chevron Corporation
Cigna Corporation
Cisco Systems, Inc.
Citigroup Inc.
The Coca-Cola Company
Comcast Corporation
ConocoPhillips
Costco Wholesale Corporation
CVS Health Corporation
Danaher Corporation
Dell Technologies Inc.
DowDuPont Inc.
Eli Lilly and Company
Exxon Mobil Corporation
Facebook, Inc.
FedEx Corporation
Ford Motor Company
General Electric Company
General Motors Company
Gilead Sciences, Inc.
The Goldman Sachs Group, Inc.
HCA Healthcare, Inc.
The Home Depot, Inc.
Honeywell International Inc.
HP Inc.
Humana Inc.
Intel Corporation
International Business Machines Corporation
Johnson & Johnson
JPMorgan Chase & Co.
The Kroger Co.
Lockheed Martin Corporation
Lowe's Companies, Inc.
Marathon Petroleum Corporation
Mastercard Incorporated
McDonald's Corporation
McKesson Corporation
Merck & Co., Inc.
MetLife, Inc.
Microsoft Corporation
Mondelēz International, Inc.
Morgan Stanley
Netflix, Inc.
NextEra Energy, Inc.
NIKE, Inc.
NVIDIA Corporation
Oracle Corporation
PayPal Holdings, Inc.
PepsiCo, Inc.
Pfizer Inc.
Philip Morris International Inc.
Phillips 66
The Procter & Gamble Company
Prudential Financial, Inc.
QUALCOMM Incorporated
salesforce.com, inc.
Starbucks Corporation
Sysco Corporation
T-Mobile US, Inc.
Target Corporation
Texas Instruments Incorporated
Thermo Fisher Scientific Inc.
The TJX Companies, Inc.
U.S. Bancorp
Union Pacific Corporation
United Parcel Service, Inc.
United Technologies Corporation
UnitedHealth Group Incorporated
Valero Energy Corporation
Verizon Communications Inc.
Visa Inc.
Walgreens Boots Alliance, Inc.
Walmart Inc.
The Walt Disney Company
Wells Fargo & Company

Eight companies are new to the 2019 Survey.
75 of the Top 100 Companies are listed on the NYSE and 25 companies are listed on the Nasdaq.

Creative direction and design: Odgis + Company

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