Matters To Consider for the 2023 Annual Meeting and Reporting Season

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Companies have important decisions to make as they prepare for the 2023 annual meeting and reporting season.

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

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Reassess Business and Risk Factor Disclosures

As always, companies should consider whether the business and the risk factor sections of their annual reports on Form 10-K (or Form 20-F, in the case of foreign private issuers) warrant any updates or new disclosures. Companies must continually monitor recent developments, especially given the myriad issues facing companies today: Economic uncertainty, market volatility, the ongoing effects of the COVID-19 pandemic and global conflict all could potentially affect business and present new risks.

Among other issues, companies should consider the following recent developments when assessing and preparing for upcoming filings:

- **Inflation and interest rates**. Based on the consumer price index, U.S. inflation is nearly double its peak earlier this century. In addition, the U.S. Federal Reserve has raised its benchmark interest rates at the fastest pace since the 1980s. As a result, many companies are facing increased capital and operating costs as well as challenges from exchange rate conditions and the discretionary spending preferences of customers. Companies with substantial amounts of debt might also consider risk factor disclosure relating to the increased cost of refinancing debt.
- **Foreign exchange rate volatility**. The relative value of the U.S. dollar is currently at its highest level since 2000, appreciating sharply against many foreign currencies. As a result, companies with substantial foreign operations may experience some vulnerability when converting results in foreign currencies to U.S. dollars for financial reporting purposes. This effect of foreign currency translation may impact companies' results of operations, and many companies have recently focused on constant currency translations to smooth these results.
- **The Inflation Reduction Act**. On August 16, 2022, the Inflation Reduction Act of 2022 was enacted, which introduced a 15% corporate minimum tax based on "adjusted financial statement income" exceeding $1 billion, a 1% excise tax on net stock repurchases by U.S. public corporations and new and expanded energy-related tax credits. This law may materially impact certain companies' effective tax rate, cash tax or other tax liabilities.[1]
- **Russia's invasion of Ukraine**. In response to Russia's invasion of Ukraine, the U.S., the U.K., the EU and other countries have imposed financial and economic sanctions and export control measures on certain industry sectors and parties in Russia. Potential adverse impacts to certain companies arising from the conflict and related sanctions may include supply chain disruptions, reduced consumer demand and increased costs for transportation, energy and raw materials. In addition, many companies have completely shut down their Russian operations, which could have an impact on results of operations.
- **Supply chain disruptions**. Companies should consider the impact of supply chain disruptions on their businesses. Potential adverse impacts to companies may include, among others, increased costs, inventory shortages, shipping and project completion delays and inability to meet customer demand.
- **Climate change**. The U.S. Securities and Exchange Commission (SEC) recently bolstered its focus on climate-related disclosures. Companies should evaluate their disclosure obligations concerning climate change matters, including risks associated with climate change,

[1] See our September 21, 2022, client alert "Senate Passes Landmark Bill With Climate, Tax, Energy and Health Care Implications."

by reviewing the SEC's interpretive release "Commission Guidance Regarding Disclosure Related to Climate Change" (February 2, 2010) and consider whether any updates are relevant or necessary. Companies should keep in mind that voluntary enhanced climate change disclosure, including targets, could require additional disclosure in the future under the SEC's proposed rules.[2]

Companies should also assess any other significant risks or changes to their business and industry when preparing their annual report filings, in addition to assessing any material changes to existing business or risk factor disclosures on a quarterly basis.

[2] See the sections of this guide titled "Consider the Impact of Climate Change and ESG in Company Disclosures" and "Reassess Disclosure Controls and Procedures" for additional information.

Comply With Updated SEC Filing Requirements

EDGAR Filing of Glossy Annual Reports

In June 2022, the SEC adopted final rule amendments mandating the electronic filing on EDGAR of the "glossy" annual reports that companies use as part of their annual meeting proxy materials.[3] The amendments apply to companies that disseminate glossy annual reports to shareholders (i) furnished pursuant to Exchange Act Rule 14a-3(c) or 14c-3(b), (ii) under the requirements of Form 10-K for filers reporting pursuant to Exchange Act Section 15(d) or (iii) by foreign private issuers on Form 6-K pursuant to Exchange Act Rule 13a-16 or 15d-16.

The amendments clarify that the electronic submission of glossy annual reports to the SEC should capture the graphics, styles of presentation and prominence of disclosures (including text size, placement, color and offset, as applicable) contained in the reports and should not reformat, resize or otherwise redesign the report for purposes of the submission on EDGAR. Currently, EDGAR only supports the use of portable data format (commonly referred to as PDF) for the filing of glossy annual reports. If EDGAR is upgraded in the future to accommodate alternative formats, the SEC will update the EDGAR Filer Manual accordingly.

The compliance date for the mandatory electronic filing of glossy annual reports is January 11, 2023. Companies and their vendors should add this requirement to their 2023 proxy season checklist.

Potential Exchange Act Disclosure Arising From Russia Sanctions

In response to Russia's invasion of Ukraine, the U.S. government has imposed an unprecedented number of sanctions and export control measures since early March 2022.[4] Specifically, numerous Russian entities (including the Federal Security Service of the Russian Federation) and individuals have been designated as subject to Executive Order No. 13382, bringing them within the scope of the disclosure requirements of the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA).

Publicly reporting companies doing business with Russia or Russian entities or individuals need to check for potential application of the disclosure requirements under the ITRA. The statute requires Form 10-K and Form 10-Q (or Form 20-F, in the case of foreign private issuers) disclosure if, during the period covered by the report, the company or any affiliate, among other things, knowingly conducted any transaction or dealing with any person for whom the property and interests in property are subject to an applicable sanction. If a company is required to report this activity in its annual or quarterly report, it must also separately file with the SEC, at the same time it files its annual or quarterly report, a notice that such disclosure is contained in the report.

Disclosures for Issuers With Auditors Not Subject to PCAOB Inspection

Pursuant to the SEC's rules implementing congressionally mandated submission and disclosure requirements of the Holding Foreign Companies Accountable Act (HFCAA), a number of additional specified disclosures are required in annual reports on Forms 10-K, 20-F, 40-F and N-CSR (as the case may be) for registrants that the SEC identifies (SEC-identified issuers) as having filed an annual report on Forms 10-K, 20-F, 40-F or N-CSR with an audit report issued

[3] See our June 22, 2022, client alert "SEC Modernizes Electronic Filing Requirements."

[4] See our various client alerts available under "Update on Russia Sanctions" (2022).

by a registered public accounting firm (i) that is located in a foreign jurisdiction and (ii) that the Public Company Accounting Oversight Board (PCAOB) has determined it is unable to inspect or investigate completely because of a position taken by an authority in that jurisdiction.[5]

While these disclosure requirements continue to apply, on August 26, 2022, the PCAOB signed a Statement of Protocol Agreement with the China Securities Regulatory Commission and China's Ministry of Finance that could obviate the need for providing HFCAA-mandated disclosures for certain SEC-identified issuers and avert the mandatory delisting of approximately 200 China-based issuers from U.S. stock exchanges required under the HFCAA.

The HFCAA, enacted in 2020, prohibits the trading of securities of a non-U.S. company on U.S. stock exchanges or the over-the-counter market if the PCAOB has determined that it has been unable to inspect the company's accounting firm for three consecutive years because of a position taken by an authority in the company's jurisdiction.[6] According to the SEC, the Statement of Protocol Agreement established a specific, accountable framework to make possible complete inspections and investigations by the PCAOB of audit firms based in China and Hong Kong, which could prevent the mandated delistings under the HFCAA. At the same time, the SEC and PCAOB each have cautioned that the framework is merely a first step and meaningful only to the extent the PCAOB actually can inspect and investigate completely audit firms in mainland China and Hong Kong.

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

[6] See our December 3, 2020, client alert "Holding Foreign Companies Accountable Act Poised To Be Signed Into Law."

The PCAOB progress (or lack thereof) working with its Chinese counterparts will inform its reassessment, mandated by the end of 2022, of its ability to appropriately inspect and investigate audit firms in mainland China and Hong Kong. If, notwithstanding the Statement of Protocol Agreement, the PCAOB continues to be stymied in its efforts, the SEC and the PCAOB have made clear that impacted issuers will be subject to conditional trading prohibitions and delisting in the U.S., consistent with the requirements of the HFCAA.

Update Form 10-K, 20-F or 40-F Cover Page

As noted in the section of this guide titled "Prepare for Final Clawback Rules Under Dodd-Frank," the new clawback rules amended the cover page of Forms 10-K, 20-F and 40-F to add the following two checkboxes related to those rules:

- If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements. ☐
- Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b). ☐

The addition of these checkboxes will become effective on January 27, 2023, although the stock exchanges will have until November 27, 2023, to adopt new clawback listing standards. It remains unclear whether the SEC would expect companies to include these checkboxes in their Forms 10-K, 20-F and 40-F filed after January 27, 2023, but before the effective date of the applicable stock exchange's listing standards.

Note the Status of Recent and Pending SEC Rulemakings

In 2022, the SEC issued a number of new proposed and final rules. Under SEC Chair Gary Gensler, the SEC has pursued a robust regulatory agenda and released new guidance on several key topics. Significant SEC regulatory developments are summarized below.

Climate-Related Disclosures

On March 21, 2022, the SEC proposed long-anticipated rules mandating climate-related disclosures in companies' annual reports and registration statements.[7] The proposed rules would add extensive and prescriptive disclosure items requiring companies, including foreign private issuers, to disclose climate-related risks and greenhouse gas (GHG) emissions. In addition, the proposed rules would require the inclusion of certain climate-related financial metrics in a note to companies' audited financial statements.

We anticipate that final rules will be adopted in 2023, and litigation challenging such rules will likely follow. However, companies should still consider how to begin collecting 2023 GHG emissions data and other information necessary to comply with the potential disclosure and financial statement requirements. Similarly, companies should begin preparing for the new rules by evaluating the impact on their existing disclosure controls and procedures, as well as internal control over financial reporting with respect to GHG emissions and other climate-related disclosures.[8]

Cybersecurity Disclosures

On March 9, 2022, the SEC proposed rules intended to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance and incident reporting.[9]

The proposed rules would amend Form 8-K to require companies to provide disclosure within four business days after the company determines that it has experienced a material[10] "cybersecurity incident."[11] Additionally, companies would be required to disclose in quarterly reports on Form 10-Q or annual reports on Form 10-K for the period in which the incident occurred (i) any material changes, additions or updates to a previous disclosure under newly proposed Item 1.05 of Form 8-K and (ii) any individually immaterial cybersecurity incidents not previously disclosed that become material in the aggregate.

The proposed rules would also require enhanced disclosures about cybersecurity risk management and cybersecurity governance. For example, the rules would require companies to disclose in proxy statements and annual reports on Form 10-K the cybersecurity expertise of any members of the board, including the name(s) of any such director(s) and a description of the nature of the expertise. The proposed rule includes a nonexclusive list of criteria[12] that companies would need to consider in reaching a determination on whether a director has expertise in cybersecurity.

[7] See our March 24, 2022, client alert "SEC Proposes New Rules for Climate-Related Disclosures."

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

[9] See our March 11, 2022, client alert "SEC Proposes New Rules for Cybersecurity Risk Management, Strategy, Governance and Incident Disclosure."

[10] Materiality for purposes of the proposed rules is consistent with the standard established by case law.

[11] "Cybersecurity incident" is defined in proposed Regulation S-K Item 106(a).

[12] These criteria include: (i) whether the director has prior work experience in cybersecurity; (ii) whether the director has obtained a certification or degree in cybersecurity; and (iii) whether the director has knowledge, skills or other background in cybersecurity.

In light of the proposed rules, companies may want to consider how their disclosures under the proposed rules would look and whether their current cybersecurity incident response plans include adequate escalation and assessment protocols to meet applicable regulatory disclosure deadlines.

Rule 10b5-1 Plans

In December 2021, in response to increasing scrutiny of insider trading practices by individuals and issuers, the SEC proposed rule amendments relating to rule 10b5-1 trading plans and share repurchases. The proposed amendments to Rule 10b5-1 would add new conditions to the availability of the affirmative defense to insider trading liability provided by Rule 10b5-1 trading plans.[13]

The proposed rule amendments would also introduce the following new disclosure requirements:

Insider Trading Policies and Procedures: Companies, including foreign private issuers, would be required to disclose, on an annual basis, the company's insider trading policies and procedures. If no such policies or procedures are in place, the company would need to explain why.

Adoption, Modification and Termination of Rule 10b5-1 Plans and Other Trading Arrangements: Companies would be required to provide quarterly disclosure of the adoption, modification and termination of the company's Rule 10b5-1 plans and other preplanned trading arrangements, as well as those of its directors and officers.

Options and Similar Equity Grants: Companies would be required to disclose policies and practices on the timing of awards of options, stock appreciation rights and similar instruments with option-like features in relation to the disclosure of material nonpublic information.

The proposed rule amendments would also introduce new disclosure requirements for Section 16 filers. A mandatory Rule 10b5-1(c) checkbox would be added to Forms 4 and 5, where filers would have to indicate whether they made a reported transaction under a Rule 10b5-1 plan, in which case filers would also need to provide the date the plan was adopted. A second, optional checkbox would allow filers to indicate whether they made a reported transaction under a plan not intended to qualify for the Rule 10b5-1 affirmative defense. Additionally, filers would no longer report bona fide gifts of equity securities on Form 5, but instead on Form 4 before the end of the second business day following the date of the gift.

Share Repurchases

In the same December 2021 release as the Rule 10b5-1 proposal, the SEC proposed rule amendments relating to share repurchases.[14] The proposed share repurchase rules would significantly alter the current share repurchase disclosure framework by requiring next-business-day disclosure of repurchases on a new Form SR and enhancing existing share repurchase disclosure requirements under Regulation S-K Item 703.

Universal Proxy

During 2022, the SEC took several actions regarding proxy rules. On November 17, 2021, the SEC adopted rules mandating the use of universal proxy cards in contested elections.[15] Requiring that the names of all nominees appear in both the company's proxy card and the dissident's proxy card will permit shareholders to "mix and match" from the competing slates of candidates without having to attend the shareholder= meeting. The new rules took effect for shareholder meetings held after August 31, 2022, and do not apply to elections held by registered investment companies and business development companies.

Board Diversity

The SEC has indicated that it plans to propose rules to require enhanced board and workforce diversity disclosures. These rules would likely be similar to Nasdaq's board diversity rules, which became effective in 2022. However, in light of the legal challenges to Nasdaq's board diversity and disclosure rules and uncertainty regarding the outcome, which are discussed further in the section of this guide titled "Consider Recommendations to Increase Board Diversity and Expertise and Enhance Related Disclosures," the SEC may take a wait-and-see approach before proposing new rules for diversity disclosures.

Human Capital Management

The SEC has indicated that it plans to propose rules that would expand the human capital disclosure requirements adopted in

[13] See our December 20, 2021, client alert "SEC Announces Proposals Relating to Rule 10b5-1, Share Repurchases and Other Matters."

[14] See our December 20, 2021, client alert "SEC Announces Proposals Relating to Rule 10b5-1, Share Repurchases and Other Matters."

[15] See the SEC's adopting release, "Universal Proxy" (November 17, 2021).

2020[16] to include specific topics, including workforce diversity. Chair Gensler noted in remarks on June 23, 2021, that a rulemaking proposal “could include a number of topics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics, including diversity, and health and safety.”[17]

[16] See the SEC’s adopting release “Modernization of Regulation S-K Items 101, 103, and 105” (August 26, 2020).

[17] See our June 28, 2021, client alert “Chair Gensler’s Insight on the SEC’s New Regulatory Agenda.”

The SEC’s sustained focus on board and workforce diversity disclosure and the inclusion of the topic in its spring 2022 short-term rulemaking agenda indicate that the staff likely will take a closer look at companies’ human capital disclosures leading up to the rulemaking stage. Accordingly, companies may consider proactively reviewing and enhancing board and workforce diversity disclosures in proxy statements and annual reports on Form 10-K.

Assess the Impact of SEC Staff Comments

The staff of the Disclosure Review Program (DRP) in the SEC's Division of Corporation Finance has remained quite active. During the 12-month period ended June 30, 2022, the staff issued approximately 10% more comment letters on company filings compared to the prior year period.[18] This uptick in comment letters reversed the downward trend of recent years. In addition to the general areas of focus of staff comments (discussed below), the staff launched new initiatives focused on disclosures related to climate change and corporate governance.[19]

The Division of Corporation Finance also announced the addition of two new review offices to the DRP — the Office of Crypto Assets and the Office of Industrial Applications and Services.[20] The Office of Crypto Assets will continue the work currently performed across the DRP to review filings involving cryptoassets. The Office of Industrial Applications and Services will oversee filings currently assigned to the Office of Life Sciences for companies that are not pharma, biotech or medicinal products companies. The addition of these two new offices reflects the recent growth in the cryptoasset and the life sciences industries.

Comment Trends

The use of non-GAAP financial measures remained the most frequent area generating staff comment. Management's discussion and analysis of financial condition and results of operations (MD&A), segment reporting and revenue recognition ranked second, third and fourth, respectively, once again comprising the top four most frequent comment areas. Climate-related disclosures moved into the top 10 areas of comment for the first time, primarily due to the SEC staff's application of the Sample Letter to Companies Regarding Climate Change Disclosures that the staff of the SEC's Division of Corporation Finance issued in September 2021.[21] Comments on acquisitions and business combinations were also one of the top 10 comment areas this year for the first time since 2019, mainly driven by an increase in deal activity. Comments on contingencies (ranked eighth last year) and income taxes (ranked tenth last year) dropped out of the top 10 comment areas this year.

Areas of Focus

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

Non-GAAP Financial Measures: The SEC staff continues to focus on non-GAAP financial measures and compliance with the staff's related interpretive guidance. Although staff comments have remained focused on areas of historical interest for the staff, such as whether the most directly comparable GAAP financial measure is presented with equal or greater prominence relative to the non-GAAP measure, the staff has also focused on adjustments to non-GAAP measures that could be viewed as resulting in "individually tailored recognition and measurement methods."[22] These comments have objected to, among other things, excluding the impact of recently revised accounting standards, such as those related to revenue

[18] See Ernst & Young's *SEC Reporting Update* "Highlights of Trends in 2022 SEC Comment Letters" (September 8, 2022).

[19] For more information, see the sections of this guide titled "Consider the Impact of Climate Change and ESG in Company Disclosures" and "Revisit Board Leadership and Risk Oversight Disclosures."

[20] See the SEC's press release "SEC Division of Corporation Finance to Add Industry Offices Focused on Crypto Assets and Industrial Applications and Services" (September 9, 2022).

[21] For more information on climate-related disclosure, see the section of this guide titled "Consider the Impact of Climate Change and ESG in Company Disclosures."

[22] See the SEC staff's Compliance & Disclosure Interpretations for Non-GAAP Financial Measures Question 100.04 (May 17, 2016).

recognition and credit losses. In addition, the staff continues to question how pandemic-related non-GAAP adjustments were incremental to and separable from normal operations. The staff has also continued to object to the use of a particular non-GAAP measure that it believes to be misleading and thus unable to be disclosed, notwithstanding compliance with the SEC's non-GAAP rules.

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

MD&A: The 12-month period ended June 30, 2022, represents the first period in which companies were required to comply with the amended MD&A disclosure requirements adopted by the SEC in November 2020.[23] While the SEC staff commented on the application of a number of the amended MD&A disclosure requirements during the period, SEC staff comments on MD&A continued to focus on historical areas of interest, with the most common topic being the results of operation. For example, the staff continues to request that companies quantify material changes in operations and include offsetting factors.

The staff also continued to focus on key performance indicators (KPIs) and operating metrics, including period-over-period comparisons and whether companies have disclosed performance indicators used by management that would be material to investors. KPIs can be financial or nonfinancial and vary based on a company's industry and business. In January 2020, the SEC issued interpretive guidance regarding disclosures required for KPIs and other metrics in MD&A. While the guidance generally is consistent with prior statements from the SEC staff, the issuance of commission-level guidance was noteworthy in that it demonstrated a greater interest in the use and disclosure of KPIs.

[23] See our November 25, 2020, client alert "SEC Amends MD&A and Other Financial Disclosure Requirements" for more information on the amended MD&A disclosures requirements adopted by the SEC in November 2020.

The SEC staff comments on MD&A have also focused on known trends or uncertainties, particularly those related to macroeconomic factors such as inflation and rising interest rates, supply chain issues and Russia's invasion of Ukraine. For instance, in applying the Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues issued in May 2022, the staff has asked registrants to describe any known trends and uncertainties "arising from, related to, or caused by the global disruption" from Russia's actions. SEC staff comments have also asked about known and anticipated events and trends that may impact the company's future liquidity and capital resources as a result of supply chain disruptions. In addition, the SEC staff has asked companies to discuss in detail whether inflation or supply chain disruptions have materially affected their outlook or business goals and to identify actions planned or taken, if any, to mitigate inflationary pressure or supply chain disruptions. The SEC staff also has continued to ask registrants to discuss how they expect the pandemic will impact future results both in the near- and long-term, including whether they expect COVID-19 to impact future operations differently than it has affected the current period.

We expect to see more SEC staff comments on these macroeconomic trends in MD&A, given that supply chain disruptions and the Russia-Ukraine conflict continue, inflation remains at historically high levels and interest rates continue to rise. As a result, we encourage companies to continually reassess and update their MD&A disclosure in light of macroeconomic trends and uncertainties. Companies should also think creatively about the kinds of forward-looking information they can provide to investors, as historical information may be relatively less significant given the economic and operational uncertainties resulting from macroeconomic trends. In doing so, companies should consider CF Disclosure Guidance Topic No. 9 and No. 9A related to COVID-19 and supply chains as well as the staff's sample comment letter on the direct and indirect effects of Russia's invasion of Ukraine, as many of their disclosure considerations could apply to these macroeconomic trends. For further detail on SEC guidance on Russia's invasion of Ukraine, supply chain and inflation disclosures, see the section of this guide titled "Reassess Business and Risk Factor Disclosures."

Consider the Impact of Climate Change and ESG in Company Disclosures

The SEC continues to focus on environmental, social and governance (ESG) matters such as climate change, board diversity, human capital management and cybersecurity risk governance.[24] Notably, in March 2022, the SEC proposed extensive and prescriptive disclosure rules related to climate change. As discussed in our March 24, 2022, client alert "SEC Proposes New Rules for Climate-Related Disclosures," if adopted substantially as proposed, those rules are expected to require significant time and resources for companies to prepare the mandated disclosures.[25]

In addition, while the SEC has not yet adopted specific disclosure rules regarding climate change and other ESG matters, companies should remember that they need to disclose any material impact of such matters under the SEC's existing rules. For example, beginning in September 2021, as explained in our September 22, 2021, client alert "SEC Staff Issues Detailed Form 10-K Comments Regarding Climate-Related Disclosures," the staff in the SEC's Division of Corporation Finance has issued detailed, stand-alone comment letters regarding climate-related disclosures (or lack thereof) in companies' most recent Form 10-K filings. The SEC staff continued to issue such comment letters in 2022, reminding companies to disclose in their periodic filings with the SEC any material climate-related risks, past impacts on company operations and/or known trends or uncertainties.

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

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

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

- whether and to what extent to incorporate into SEC filings climate change-related disclosures provided outside of SEC filings — such as those included in a stand-alone ESG, sustainability, corporate responsibility or similar report;
- any past or future capital expenditures for climate change-related initiatives;
- physical effects of climate change on the company's property or operations;
- weather-related impacts on the cost or availability of insurance;

[24] See, *e.g.*, our client alerts "SEC Primed To Act on ESG Disclosure" (April 30, 2021) and "H1 2022 – ESG Trends and Expectations" (July 28, 2022).

[25] See the section of this guide titled "Note the Status of Recent and Pending SEC Rulemakings" for further details.

- compliance costs related to climate change, including costs associated with existing or pending legislation and regulation related to climate change;
- litigation risks related to climate change and the potential impact to the company;
- effects of transition risks related to climate change that may affect the company's business, financial condition and results of operations (examples include risks related to policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks or technological changes); and
- the company's purchase or sale of carbon credits or offsets and any related effects on the company's business, financial condition and results of operations.

Companies should also consider discussing material ESG risks and impacts in their other SEC disclosures, such as the MD&A, risk factors and descriptions of business or legal proceedings, as well as in financial statements and accompanying notes. In addition, companies may want to revisit or enhance their 10-K (or 20-F) and proxy statement disclosures regarding climate change, human capital management, diversity, equity and inclusion, cybersecurity governance and other ESG matters in light of the considerations outlined above.

Reassess Disclosure Controls and Procedures

SEC rules require public companies to maintain and regularly evaluate the effectiveness of disclosure controls and procedures (DCPs). Chief executive officers (CEOs) and chief financial officers (CFOs) also must certify the effectiveness of the company's DCPs on a quarterly basis.[26] While these requirements are not new, given the SEC's continuing focus on the effectiveness of disclosure controls and related enforcement actions, companies should periodically reassess their DCPs and consider any necessary changes to help ensure the consistency, accuracy and reliability of their voluntary and required disclosures.

The SEC's Continuing Focus on ESG Disclosure Controls

In recent years, companies have expanded their disclosure about ESG matters largely on a voluntary basis outside of SEC filings in stand-alone ESG, sustainability, corporate responsibility or similar reports. At the same time, more companies are providing ESG disclosures, particularly climate-related information, in their SEC filings. One study found that, as of June 2022, over 90% of S&P 500 companies included at least some mention of climate-related information in their annual report on Form 10-K, although the type and length of the information included varied from company to company.[27]

Despite the voluntary nature of some of these disclosures, companies should remain vigilant about the accuracy of their ESG disclosures. As discussed in our April 30, 2021, client alert "SEC Primed To Act on ESG Disclosure," in March 2021 the SEC established the Climate and ESG Task Force in the Division of Enforcement, with a mandate to identify any material gaps or misstatements in companies' disclosures regarding climate and other ESG matters under existing disclosure requirements. Since then, the Enforcement Division has been pursuing ESG actions and is expected to continue to hold companies accountable for material misstatements or omissions regarding ESG-related matters either in voluntary disclosures or SEC filings.

For example, in April 2022, the SEC charged a Brazilian mining company with allegedly making false and misleading claims about the safety of its dams in the company's sustainability reports and in SEC periodic filings. In September 2022, the SEC settled a charge against an American mineral producer for alleged material misstatements about the company's mine operations made on multiple earnings calls and SEC periodic filings, which the SEC attributed to failures in the company's DCPs.

In addition, recent SEC staff comment letters have focused on the differential between ESG disclosures in SEC filings compared to more expansive ESG disclosures provided outside of SEC filings (such as a stand-alone ESG, sustainability, corporate responsibility or similar report). This focus is another indication that companies should reassess their DCPs and consider whether any changes are needed to conform their ESG disclosures for accuracy across all outlets.

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

[27] See Center for Audit Quality's "S&P 500 10-K Analysis" (October 2022).

Director Independence and Interlock Disclosure

Another recent SEC focus area in DCPs relates to director independence and "interlocking" relationships between executives and members of compensation committees. For example, in January 2022, the SEC settled charges against an American e-commerce company for alleged failures to adequately evaluate and disclose certain material information regarding the independence of members of its board of directors, the independence of board committees and the existence of interlocking relationships between its directors and executive officers.[28] According to the SEC's settlement order, the company appointed a new director who was determined to be independent at the time of appointment but later became CFO of another public issuer on whose board and compensation committee the company's CEO also served, resulting in an interlocking relationship between the company's CEO and the new director. The SEC's order found that the company did not maintain adequate DCPs to identify and analyze potential director independence and issues of interlocking and failed to disclose the interlocking relationship and the director's resulting loss of independence in its SEC filings.

[28] See the SEC's press release "SEC Charges Lifestyle E-Commerce Company for Failing To Evaluate and Disclose Board Member's Lack of Independence" (January 7, 2022).

Considerations for Implementing More Robust DCPs

Given the ongoing SEC focus on the effectiveness of DCPs, companies should periodically reassess their DCPs to help ensure the existing processes bring all potentially material information to management's attention in a timely manner and result in adequate disclosures as appropriate.

In addition, due to the lack of guidance on DCPs regarding ESG-related disclosures, companies should develop and tailor a process that is consistent with their business, management and supervisory practices. Some companies may find it appropriate to integrate voluntary ESG reporting into their existing DCPs for SEC reporting, while others may develop DCPs for voluntary ESG reporting as a separate structure with separate processes. Ideally, companies should vet voluntary ESG disclosures through a controls process as robust as their DCPs for disclosures included in SEC filings.[29]

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

Revisit Internal Procedures Relating to Insider Trading, Regulation FD, Cybersecurity and Form 144 Filing

Insider Trading

The SEC continues to focus on insider trading issues. As discussed above, the SEC has proposed new rules relating to Rule 10b5-1 trading plans and issuer repurchases[30] and brought the below recent insider trading enforcement actions. The SEC also has been escalating its investigation into insider trading cases, using data analysis tools to help detect suspicious trading patterns.[31] In addition, the SEC recently settled charges against officers for trading pursuant to Rule 10b5-1 plans that they allegedly entered into while in possession of material nonpublic information.[32]

In July 2022, the SEC announced that it had filed insider trading charges against nine individuals in connection with three different alleged insider trading schemes that resulted in such individuals obtaining almost $7 million in improper gains.[33] In each of these cases, according to the SEC's complaints, the defendants traded based on material nonpublic information about the impending acquisition of another company ahead of its announcement. All nine individuals were charged with violating anti-fraud provisions of the securities laws, and the SEC sought permanent injunctive relief, disgorgement and civil penalties. The SEC's investigation is ongoing in all three cases.

The SEC's complaint in one of these actions alleges that a former chief information security officer (CISO) at a California-based technology company learned of material nonpublic information about the company's plans to acquire two companies. For each planned acquisition, before such information became public, the CISO allegedly purchased shares of the acquisition target for himself and informed his friends to make similar purchases. Their trades together generated approximately $5.2 million in profits. The second action brought by the SEC involves an investment banker who allegedly shared with a friend who was a trader at a large financial institution information he learned at work about four upcoming acquisitions. They allegedly traded on such information before its announcement, obtaining approximately $300,000 in profits. In the third action, the SEC alleges that a former FBI trainee secretly reviewed a binder of deal documents about a planned tender offer from his then-romantic partner, who was an associate attorney for the buyer's counsel on the transaction. The former FBI trainee traded on such information before it was made public and informed a friend who made similar trades, and generating aggregate profits of approximately $1.4 million.

The recent rule proposals, the above enforcement actions and the tools and resources that the SEC is employing to seek insider trading violations are reminders of the SEC's continuing focus on insider trading issues, particularly Rule 10b5-1 plans, and what may be viewed as material information by the SEC in connection with securities trading. Companies should take extra caution to follow their policies and consider all relevant factors when making disclosure determinations and when reviewing Rule 10b5-1 plans for their employees. Companies should also consider how recent SEC rule proposals impact current company practices and policies.

[30] See the section of this guide titled "Note the Status of Recent and Pending SEC Rulemakings" for further details.

[31] See the SEC's press release "SEC Files Multiple Insider Trading Actions Originating from the Market Abuse Unit's Analysis and Detection Center" (July 25, 2022).

[32] See the SEC's settlement order available in this link: https://www.sec.gov/litigation/admin/2022/33-11104.pdf.

[33] See *id.*

Regulation FD

Regulation FD prohibits selective disclosure of material nonpublic information to securities market professionals and shareholders who are reasonably likely to trade based on the information. Although SEC enforcement actions alleging Regulation FD violations are rare, the SEC's recent, ongoing litigated action against a large public company and three of its investor relations (IR) executives serves as a reminder that companies should remain vigilant in complying with the requirements of Regulation FD when disclosing material nonpublic information.

In March 2021, the SEC brought charges against a large public company for allegedly "repeatedly violating" Regulation FD, and three of its IR executives for "aiding and abetting" the alleged Regulation FD violations, by selectively disclosing material nonpublic information to several research analysts.[34] According to the complaint, the company became aware in March 2016 that a steeper-than-expected decline in its first quarter smartphone sales would cause revenues to fall short of analysts' revenue estimates. The complaint alleges that three IR executives made private, one-on-one phone calls to approximately 20 sell-side analysts, disclosing internal smartphone sales data and the impact that data would have on internal revenue metrics, in an attempt to avoid missing revenue estimates for a third consecutive quarter. The complaint further alleges that promptly after those calls, the contacted analysts substantially reduced their revenue forecasts, resulting in the consensus estimate falling to just below the level that the company ultimately reported to the public in its first quarter earnings release.

The SEC, the company and the three IR officers all separately filed motions for summary judgment on the SEC's March 2021 complaint, and the court denied all those motions on September 8, 2022. In its 129-page opinion, the court found "formidable" evidence that the three IR officers improperly warned analysts in March and April 2016 that lower-than-expected smartphone sales would decrease overall revenue. The court also concluded that a reasonable jury could find for either side on the issue of whether the three IR officers had intent to defraud. This case will now proceed to trial, barring settlement.

Cybersecurity

The SEC continues to make cybersecurity a priority. As discussed above, the SEC has made several rule proposals relating to cybersecurity[35] and brought the below recent enforcement actions. These actions should continue to serve as a warning to companies to evaluate the adequacy of their policies and procedures.

Recent SEC Enforcement Matters

In August 2021, the SEC settled charges against a London-based foreign private issuer that publishes educational materials and provides other services to school districts in the United States for misleading investors about a cybersecurity breach and having inadequate disclosure controls and procedures.[36] In September 2018, the company was notified of a vulnerability in its servers and that a patch was available to address the issue. The company took no action until March 2019 after it learned that several million rows of data were stolen, including personally identifying information (PII) stored on a server. The company implemented the patch to address the concern only after the breach. In July 2019, the company sent notice of the breach to impacted customer accounts without providing full details of the breach. Shortly after sending the notice, the company filed a Form 6-K that discussed its data privacy risks but did not disclose the fact that one had occurred. After receiving a media inquiry in late July 2019, the company only then issued a statement informing investors and the public about the breach, and the public disclosures made misstatements about the nature of the breach and the data involved. The SEC described the company's statement as understating the nature and scope of the breach and overstating the company's data protections. The company paid a $1 million penalty.

In August 2021, the SEC also settled charges with eight SEC-registered broker-dealers and/or investment advisers affiliated with three firms for various cybersecurity failures leading to the exposure of PII of thousands of customers and clients.[37] The alleged failures included failure to (i) protect accounts in a manner consistent with company policies, (ii) adopt and implement policies and procedures to review customer communications leading to misleading statements to such customers, (iii) adopt and implement firmwide enhanced security measures until years after discovery of a breach and (iv) adopt written policies and procedures in a timely manner after discovering a breach and implement those additional security measures firmwide. The firms paid penalties in an aggregate amount of $750,000.

[34] See the SEC's press release "SEC Charges AT&T and Three Executives With Selectively Providing Information to Wall Street Analysts" (March 5, 2021).

[35] See the section of this guide titled "Note the Status of Recent and Pending SEC Rulemakings" for further details.

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

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

In another action in June 2021, the SEC settled charges with a real estate settlement services company relating to disclosure controls and procedures violations with respect to a cybersecurity vulnerability that exposed over 800 million title and escrow document images, including images containing sensitive PII.[38] A journalist brought the vulnerability to the attention of the company. In response, the company issued a public statement and disclosed the event in a Form 8-K. However, the senior executives responsible for producing the public response were not informed of certain details relevant to their assessment in developing such a response. For example, the SEC found that the company's disclosure controls and procedures failed to inform the senior executives that the company's information security personnel were previously aware of the vulnerability months earlier and that the company failed to address the issue in accordance with its policies. The company paid a $487,616 penalty.

Recommended Actions

In light of these recent enforcement actions and continued SEC focus on cybersecurity, companies should ensure that they have adequate policies and procedures in place to address their particular business needs, follow those policies and procedures and address any known threats or breaches in a timely manner. In particular, communicating information about any threats or breaches to individuals responsible for making public disclosures is of paramount importance so that all relevant information can be evaluated when communicating to impacted customers and the public. Companies should also consider how recent SEC rule proposals may impact their current practices and policies.

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

Mandatory Electronic Filing of Form 144

In June 2022, the SEC adopted rule and form amendments that require electronic filing of all Forms 144 on EDGAR. Previously, companies could file Form 144 in paper format, which many reporting persons elected to use. The mandatory electronic filing of Forms 144 will commence on April 13, 2023.

For compliance with this rule change, persons selling under Rule 144 will need to make sure that they have all necessary EDGAR codes. Directors and officers should confirm with their brokers whether any entities or trusts they are affiliated with will need separate EDGAR codes. While brokers have typically handled the filing of Forms 144 for directors and officers, brokers may now ask companies to assist with the electronic filing of such forms. In that case, companies should make sure they have capacity and appropriate internal procedures to help company affiliates selling under Rule 144 comply with their reporting obligations.

Prepare for New Pay-Versus-Performance Disclosures

On August 25, 2022, the SEC adopted final rules requiring public companies to disclose the relationship between the executive compensation actually paid to the company's named executive officers (NEOs) and the company's financial performance. The final rules implement the "Pay Versus Performance" disclosure requirements mandated by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted in 2010 (Dodd-Frank Act).

Overview

Item 402(v) of Regulation S-K contains the "Pay Versus Performance" disclosure requirements. The new requirements consist of three components: (i) a pay-versus-performance table that includes metrics from the previous five fiscal years such as CEO and NEO compensation "actually paid," cumulative total shareholder return (TSR) for the company and its peer groups, financial performance measures and the company's net income; (ii) a description of the relationship between compensation "actually paid" and the company's performance metrics; and (iii) a tabular list of important financial measures that the company selected to link the compensation "actually paid" with the performance metrics. The three components are described in detail below.

Covered Issuers and Fiscal Years

Calendar-year companies should prepare to implement these new disclosure items in their 2023 proxy statements with respect to compensation paid in fiscal year 2022. Companies generally will be required to disclose the applicable information for their five most recently completed fiscal years, provided that in the first proxy or information statement in which a company provides this disclosure, it may provide the newly required disclosure for three years instead of five years, adding another year of disclosure in each of the two subsequent annual filings.

All reporting companies that file proxies or information statements that require executive compensation disclosure are required to comply with this new rule. However, smaller reporting companies are subject to scaled disclosure requirements, including a three-year period subject to a phase-in period for the first applicable filing in which disclosure for only the two most recently completed fiscal years is required. Smaller reporting companies are also not required to provide the peer group TSR or a company-selected measure in the new table.

Emerging growth companies, foreign private issuers and registered investment companies (other than business development companies) are entirely exempt from the new disclosure requirements.

For newly public companies, disclosure is required only for the years in which the company was a reporting company pursuant to Section 13(a) or Section 15(d) of the Exchange Act. For example, for a company that completed an initial public offering (IPO) in 2022 that is not an emerging growth company, foreign private issuer or registered investment company, disclosure in the first applicable filing will be required only for 2022 (for the period following the IPO date), with each subsequent annual proxy filing including disclosure for an additional year until five years of disclosure (or three years in the case of a smaller reporting company) are provided.

Component One: Pay-Versus-Performance Table

The final rules require companies to include a new "Pay Versus Performance" table in proxy or information statements that are required to include executive compensation disclosure.

Companies must include the following information for each covered fiscal year (*i.e.*, for proxy statements filed in 2023, the covered fiscal years are 2022, 2021 and 2020):

- the total compensation of the CEO as reported in the "Total" column of the "Summary Compensation Table" (SCT) (if more than one person served as CEO during the most recent fiscal year, a separate column must be included in the Pay Versus Performance table for the total compensation paid to each CEO);
- the average total compensation of the other NEOs using the average of the amounts reported in the "Total" column of the SCT for the applicable year for each other NEO;
- the compensation "actually paid" to the CEO (if more than one person served as CEO during the most recent fiscal year, a separate column must be included in the table for the compensation "actually paid" to each CEO);
- the average total compensation "actually paid" to the other NEOs using the average of the compensation "actually paid" to each other NEO for the applicable year;
- the cumulative TSR, calculated in the same manner as the performance graph already required pursuant to Item 201(e) of Regulation S-K;
- the cumulative TSR of the company's "peer group"; for its peer group, the company must use either (a) the same index or issuers used by the company for purposes of its disclosure already included in the Form 10-K pursuant to Item 201(e)(ii) of Regulation S-K or (b) if applicable, the company's peer group used for purposes of its disclosure in the Compensation Discussion and Analysis (CD&A) pursuant to Item 402(b)(2)(xiv) of Regulation S-K;
- the net income of the company for the applicable year;
- a financial performance measure selected by the company (Company-Selected Measure) that in the company's assessment represents the single most important financial performance measure (not otherwise already included in the table (*e.g.*, net income or absolute or "peer group" TSR)) that the company used for the most recent fiscal year to link compensation actually paid to the company's NEOs to the company's performance;
- additional financial performance measures other than the Company-Selected Measure may be included in additional columns to the table, provided that the additional columns and related disclosure are clearly identified as supplemental, not misleading and not presented with greater prominence than the required Company-Selected Measure; and
- footnote disclosure to the table for any amounts deducted and added to total compensation of the NEOs to determine the amount of compensation "actually paid" (as described below) and certain related assumptions, as well as the name of each CEO and other NEO included in the table for each year and the fiscal year for which they were included.

For the TSR columns in the new table, the TSR for the earliest year in the table will represent the one-year TSR, the TSR for the next year in the table will represent the two-year TSR, and so forth, such that the TSR for the most recent fiscal year in the table will represent the cumulative TSR for the entire applicable period covered in the table. The table should weight peer group TSR based on the initial market capitalization of each peer group company as of the beginning of the earliest year included in the table. If the company uses a different peer group than the peer group used for the prior fiscal year, the company must explain the reason for the change in a footnote and provide comparison information with respect to both the old and the new peer group.

Companies should calculate executive compensation "actually paid" for the purposes of the Pay Versus Performance table using the amounts reported for the CEO and each other NEOs in the "Total" column of the SCT for the applicable year, but adjusted as follows for amounts in (i) the "Stock Awards" and "Option Awards" columns of the SCT for the applicable year and (ii) the "Change in Pension Value" column of the SCT for the applicable year:

For stock and options awards:

- subtract: the grant date fair value of equity awards granted during the applicable year that appears in the SCT for the applicable year;
- add: (i) the year-end fair value of any equity awards granted in the applicable year that are outstanding and unvested as of the end of the applicable year (for awards subject to performance conditions, based on the probable outcome of such conditions); (ii) the amount of change as of the end of the applicable year (from the end of the prior year) in the fair value (whether positive or negative) of any awards granted in prior years that are outstanding and unvested as of the end of the applicable year; (iii) for awards that are granted and vest in the same year, the fair value as of the vesting date; (iv) for awards granted in prior years that vest in the applicable year, the amount equal to the change in the fair value (whether positive or negative) as of the vesting date (from the end of the prior year); and (v) any dividends or other earnings paid on equity awards in

the applicable year prior to the vesting date that are not otherwise reflected in the fair value of such awards or included in any other component of total compensation for the applicable year;

- subtract: the amount equal to the fair value at the end of the prior year of any awards that fail to meet the vesting requirements and are forfeited in the applicable year.

For defined benefit and actuarial pension value:

- subtract: the positive amount of any aggregate change in the actuarial present value of defined benefit and actuarial pension plans that appears in the SCT for the applicable year;
- add back: (i) the actuarially determined pension service cost for services rendered during the applicable year; and (ii) any prior service costs introduced in connection with a plan amendment or initiation during the applicable year, regardless of whether any of the pension benefits are currently vested;
- subtract: the amount of any credit for reduced benefits introduced in connection with a negative plan amendment during the fiscal year.

Component Two: Description of the Relationship Between Pay and Performance

Using values reflected in the Pay Versus Performance table described above, companies must describe (i) the relationship between (a) the executive compensation "actually paid" to the CEO and the average total compensation "actually paid" to the other NEOs and (b) the company's TSR, its net income and the Company-Selected Measure and (ii) the relationship between the company's TSR and the TSR of its peer group.

Companies must also describe the relationship between (i) the executive compensation actually paid to the CEO and the average total compensation actually paid to other NEOs and (ii) any supplemental measures voluntarily included in the new table in addition to the required Company-Selected Measures. Smaller reporting companies are only required to describe (i) the relationship between the executive compensation actually paid to the CEO and the average total compensation actually paid to the other NEOs and (ii) the company's TSR and net income.

Companies can describe these relationships either through a narrative discussion, a graphical presentation or a combination of both. The relationship disclosures may be grouped together, as long as any combined description of multiple relationships is clear.

Component Three: Tabular List of Important Financial Measures

Every company also must provide an unranked tabular list of at least three, but no more than seven, financial performance measures that in the company's assessment represent the most important financial measures used by the company for the most recent fiscal year to link compensation actually paid to the company's CEO and other NEOs to the company's performance.

Companies may include nonfinancial performance measures in the tabular list if those measures are among the most important measures used by the company to link compensation actually paid to the performance and the company has disclosed at least three financial performance measures (or fewer if the company uses fewer than three measures).

The Company-Selected Measure disclosed in the Pay Versus Performance table described above must be one of the financial performance measures included in the tabular list. There are no additional disclosure requirements if the company changes the Company-Selected Measure from year to year.

Companies are not required to provide the methodology used to calculate the financial performance measures included in the tabular list but should consider if that disclosure would be helpful to understand the financial performance measures or necessary to prevent them from being confusing or misleading. If the Company-Selected Measure is not a GAAP financial measure, high-level disclosure must be provided regarding how the numbers are calculated from the company's audited financial statements, but full GAAP reconciliation is not required.

Companies that consider fewer than three financial performance measures when linking compensation to company performance are required to list only the number of financial performance measures actually considered, and a company that does not use any financial performance measures to link compensation actually paid to performance in the most recent fiscal year is not required to present a tabular list or disclose a Company-Selected Measure. Smaller reporting companies are also not required to provide a tabular list or disclose a Company-Selected Measure.

Location of Pay-Versus-Performance Disclosure

The rules provide flexibility to companies regarding the location of the new disclosure in the proxy statement. The disclosure is not required to be included in CD&A, because including the

disclosure in the CD&A may cause confusion by suggesting that the company considered the pay-versus-performance relationship in its compensation decisions for the applicable fiscal year, which may or may not be the case for all of the relationships required to be described other than the Company-Selected Measure.

Supplemental Disclosures

Companies may supplement the new disclosure by providing pay-versus-performance disclosure (in tabular format or otherwise) based on other compensation measures such as "realized pay" or "realizable pay" if they believe that such supplemental disclosures would provide useful information about the relationship between the compensation paid and the company's financial performance. The supplemental disclosure, however, may not be misleading or presented more prominently than the required new disclosure. This prominence requirement should be given particular consideration by companies with pay-for-performance discussions in the executive summaries of their proxy or information statements and may require companies to modify the way they disclose performance information in the CD&A.

Applicable Filings

The new pay-versus-performance disclosure is required in any proxy or information statement that is required to include executive compensation disclosure, including those with respect to the election of directors. The disclosure is not required in annual reports on Form 10-K (other than with respect to the incorporation of proxy disclosure by reference), Securities Act registration statements or Exchange Act registration statements (*e.g.*, registration statements on Form S-1 for IPO companies). The disclosure also will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the company specifically incorporates it by reference.

XBRL

The new disclosure must be tagged in interactive data format using Inline eXtensible Business Reporting Language (Inline XBRL). Smaller reporting companies may phase in Inline XBRL tagging.

Implications

The new disclosure requirements regarding pay versus performance became effective on October 11, 2022. Companies should prepare to incorporate these new items into those proxy or information statements that include executive compensation disclosure for fiscal years ending on or after December 16, 2022, meaning that calendar year companies will need to include this new disclosure in their proxy statements filed in 2023.

Incorporate Lessons Learned From the 2022 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2023 Pay Ratio Disclosures

Companies should consider their recent annual say-on-pay votes and best practices for disclosure when designing their compensation programs and communicating about those programs to shareholders. This year, companies should understand key say-on-pay trends, including overall 2022 say-on-pay results, factors driving say-on-pay failure (*i.e.*, those say-on-pay votes that achieved less than 50% shareholder approval), say-on-golden-parachute results and results of equity plan proposals, as well as recent guidance from the proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis.

Overall Results of 2022 Say-on-Pay Votes

Below is a summary of the results of the 2022 say-on-pay votes from Semler Brossy's annual survey[39] and trends over the last 11 years since the SEC adopted its say-on-pay rules. Overall, say-on-pay results at Russell 3000 companies surveyed in 2022 were generally the same or slightly below those in 2021.

- Approximately 96.5% and 97.2% of Russell 3000 companies in 2022 and 2021, respectively, received at least majority support on their say-on-pay votes, with approximately 93% receiving above 70% support in 2021 and 90% receiving above 70% support in 2022. This demonstrates slightly reduced say-on-pay support in 2022 compared with 2021.
- To date thus far in 2022, approximately 86.5% of Russell 3000 companies and 87.5% of S&P 500 companies have received "For" recommendations by ISS, a slight decrease from the 89% "For" average experienced in 2021.
- Russell 3000 companies received an average vote result of 89.4% approval in 2022, which is slightly lower than the average vote result of 90.4% approval in 2021.
  - The average vote result exceeded 90% approval in 2022 across multiple industry sectors, including utilities, materials, energy, financials and real estate.
  - The communication services sector featured the lowest level of average support, at 88.5%, compared with other industry sectors.
- As of September 2022, approximately 3.5% of say-on-pay votes for Russell 3000 companies failed in 2022, which was slightly higher than the 2.8% failure rate for 2021 measured in September 2021.
- Approximately 12% of Russell 3000 companies and 15% of S&P 500 companies surveyed have failed to receive a majority support for say-on-pay at least once since 2011.
- 39% of S&P 500 companies and 32% of Russell 3000 companies surveyed have received less than 70% support in a say-on-pay vote at least once since 2011.

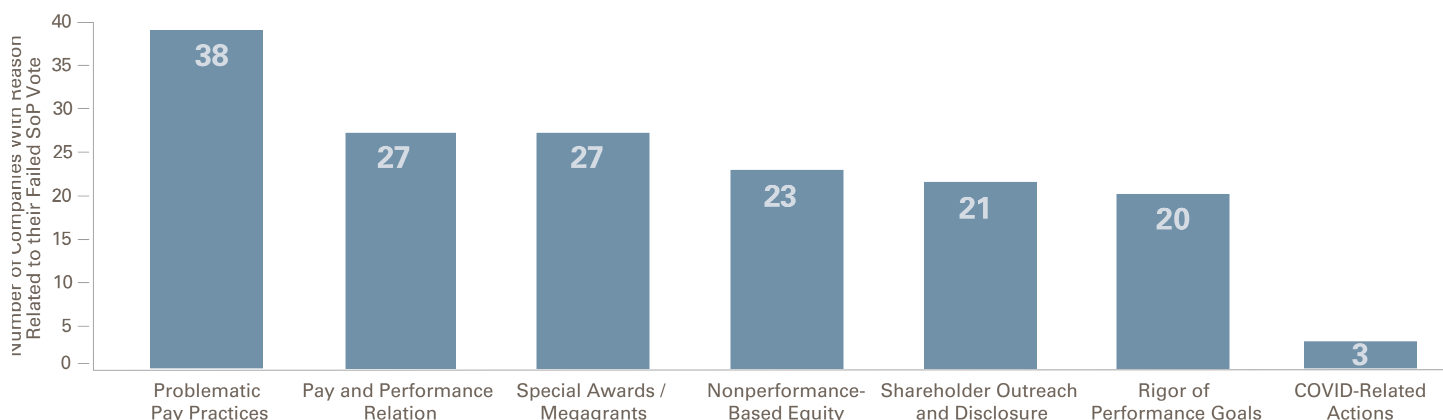
Factors Driving Say-on-Pay Failure

Overall, the most common factors voters used to reject say-on-pay proposals were problematic pay practices, pay and performance relation, special awards, non-performance-based equity, shareholder outreach and disclosure, rigor of performance goals and COVID-19-related actions, as summarized in the chart below.[40]

[39] See Semler Brossy's report "2022 Say on Pay & Proxy Results" (September 29, 2022). See also Semler Brossy's report "2021 Say on Pay & Proxy Results" (January 27, 2022). Unless otherwise noted, Semler Brossy's report is the source of pay ratio, say-on-pay and equity plan proposal statistics in this guide.

[40] See Semler Brossy's report "2022 Say on Pay & Proxy Results" (September 29, 2022).

Summary Table: Likely Causes of Failed Say-on-Pay (SoP) Votes in 2022*



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

Consistent with 2021 results, the three leading causes of say-on-pay failure for 2022 are problematic pay practices, pay and performance relations, and special awards. Notably, non-performance-based equity took a leap from the seventh leading cause to third in 2022, while COVID-19 related actions, significantly decreased in number from 18 to 3.

ISS Guidance

When evaluating pay practices, the focus of proxy advisory firms tends to center on whether a company's practices are contrary to a performance-based pay philosophy. In December of each year, ISS publishes FAQs to help shareholders and companies understand changes to ISS compensation-related methodologies. In December 2021, ISS published its most recent general United States Compensation Policies FAQ,[41] which included the following key updates:

- ISS indicated that there are no changes to the three primary quantitative pay-for-performance screens (RDA, MOM and PTA) for 2022. For meetings on or after February 1, 2022, there are slight updates to the "Eligible for FPA Adjustment" thresholds under the FPA measure.[42]
- ISS highlighted three problematic practices that carry "significant weight" and are likely to result in an adverse say-on-golden-parachute recommendation, in and of themselves, including:
  - Golden parachute excise tax gross-ups are estimated to be paid (based on amounts reported in the golden parachute tables of the merger proxy).
  - Cash severance payments are triggered solely by the occurrence of a change in control (*i.e.*, "single trigger") without disclosure indicating the executive will incur a termination in connection with the transaction.
  - Single-trigger acceleration of performance-based awards at an above-target level has occurred without disclosure of compelling rationale.
- ISS described how it accounts for a variety of pay-for-performance considerations and other factors as it evaluates proposals seeking approval of individual equity awards on a case-by-case basis, which may include (without limitation):
  - the transparency and clarity of disclosure;
  - the magnitude of pay opportunities;
  - the prevalence and rigor of performance vesting criteria;
  - the existence of shareholder-friendly guardrails and termination/CIC provisions;
  - the estimated cost of the award and/or its dilutive impact; and
  - any other factors deemed relevant.

Exceptionally large awards and "front-loaded" awards in this context are subject to heightened pay-for-performance considerations, as is the case with ISS' approach to analyzing such awards in the context of the qualitative pay-for-performance evaluation.

[41] See ISS' FAQ "United States Compensation Policies" (December 17, 2021).

[42] For more information, see ISS' Pay-for-Performance Mechanics white paper.

- ISS indicated that it continues to assess pandemic-related pay decisions based on its "U.S. Compensation Policies and the COVID-19 Pandemic — Updated for 2022 U.S. Proxy Season" FAQ published on December 7, 2021. Highlights from this publication include:
  - As in the pre-COVID-19 era, ISS will generally view midyear changes to metrics, performance targets and measurement periods, as well as programs that emphasize discretionary or subjective criteria, negatively. In certain circumstances, ISS will view lower preset performance targets (as compared to 2020) and/or modest year-over-year increases in the weighting of subjective or discretionary factors as reasonable for companies that continued to incur severe economic impacts and uncertainties as a result of the pandemic in 2021.
  - If midyear adjustments to annual incentive programs are made, ISS encourages companies to explain the necessity for such actions, including the specific pandemic-related challenges that arose and how those challenges rendered the original program design obsolete or the original performance targets impossible to achieve, as well as how changes to compensation programs are not reflective of poor management performance.
  - ISS will continue to view changes to in-progress long-term incentive cycles negatively, particularly for companies that exhibit a quantitative pay-for-performance misalignment. ISS may view modest alterations to cycles going forward as reasonable if a company continues to incur severe negative impacts over a long-term period.
  - For companies that made changes to compensation programs that normally would be viewed as concerning from a pay-for-performance standpoint, ISS may consider a company's intentions to return to a strongly performance-based incentive program going forward as a mitigating factor.
  - As ISS requires for one-time awards granted outside the context of the pandemic, companies that grant one-time awards should disclose the rationale for doing so (including the magnitude and structure of the award), as well as how the award furthers investors' interests. ISS will view the granting of one-time awards to replace forfeited incentives and/or insulate executives from lower pay outcomes as a problematic action.
  - ISS' policy regarding responsiveness to say-on-pay proposals remains consistent with prior years regarding the first two factors (*i.e.*, disclosure of the board's shareholder engagement efforts and disclosure of the specific feedback received from dissenting investors). Regarding the third factor (*i.e.*, any actions or changes made to pay programs and practices to address investors' concerns), ISS will return to its pre-pandemic application, where companies must demonstrate actions that address investors' feedback.

ISS' general United States Compensation Policies FAQ summarized which problematic practices are most likely to result in an adverse ISS vote recommendation. As described in FAQ No. 45, problematic practices include the following, which are expected to remain problematic in 2023:

- repricing or replacing of underwater stock options or stock appreciation rights without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options);
- excessive or extraordinary perquisites or tax gross-ups;
- new or extended executive agreements that provide for (i) termination or change-in-control severance payments exceeding three times the executive's base salary and bonus, (ii) change-in-control severance payments that do not require involuntary job loss or substantial diminution of duties, (iii) a definition of "good reason" termination that presents windfall risks, such as definitions triggered by potential performance failures (*e.g.*, company bankruptcy or delisting), (iv) change-in-control excise tax gross-up entitlements (including "modified" gross-ups), (v) multiyear guaranteed awards or increases that are not at risk due to rigorous performance conditions or (vi) a liberal change-in-control definition combined with any single-trigger change-in-control benefits;
- insufficient executive compensation disclosure by externally-managed issuers (EMIs) such that a reasonable assessment of pay programs and practices applicable to an EMI's executives is not possible; or
- any other provision or practice deemed to be egregious and a significant risk to investors.

ISS is expected to release a full set of updated compensation FAQs in December 2022, which will provide robust guidance for 2023.

Glass Lewis Guidance

Glass Lewis published its "2023 Policy Guidelines for the United States" in November 2022, which included the following compensation updates in effect for the 2023 proxy season:[43]

[43] See Glass Lewis' "2023 Policy Guidelines — United States" (November 18, 2022) and "2023 Policy Guidelines — ESG Initiatives" (November 18, 2022).

- Glass Lewis updated its approach to proposals requesting that companies adopt a policy whereby shareholders must approve severance payments exceeding 2.99 times the amount of the executive's base salary plus bonus. Glass Lewis may recommend shareholders vote against these proposals in instances where companies have adopted policies whereby they will seek shareholder approval for any cash severance payments exceeding 2.99 times the sum of an executive's salary and bonus.
- Beginning in 2023, Glass Lewis will raise concerns in its analysis with executive pay programs that subject less than half of an executive's long-term incentive awards to performance-based vesting conditions. Accordingly, the advisory firm revised the threshold for the minimum percentage of the long-term incentive grant that should be performance-based from 33% to 50%.

Glass Lewis also clarified the following in its 2023 policy guidelines:

- **One-Time Awards**: If one-time awards are made, companies are expected to include disclosure explaining the determination of the awards' amounts and structures.
- **Front-Loaded Awards**: Glass Lewis continues to scrutinize "megagrants," which companies often provide as front-loaded awards. In situations where a front-loaded award was intended to cover a certain portion of the regular long-term incentive grant for each year during the covered period, Glass Lewis' analysis of the remaining portion of the regular long-term incentives granted during the period covered by the award will account for the annualized value of the front-loaded portion, and Glass Lewis expects no supplemental grant to be awarded during the vesting period of the front-loaded portion. Additionally, if megagrants have been awarded and generate concerns such as excessive quantum, lack of sufficient performance conditions or excessive dilution, Glass Lewis will generally recommend against the chair of the compensation committee.
- **Pay-for-Performance**: The new rules do not impact the pay-for-performance methodology and there is no change to the methodology for the 2023 proxy season. However, Glass Lewis may review the disclosure requirements from the new rules in its evaluation of executive pay programs on a qualitative basis.
- **Recoupment Provisions**: Glass Lewis acknowledged the new regulatory developments related to the SEC's final rules regarding clawback policies and noted that, during the period between the announcement of the final rules and the effective date of listing requirements, it will continue to raise concerns about companies that maintain clawback policies that only meet the requirements set forth by Section 304 of the Sarbanes-Oxley Act of 2002 (SOX). Glass Lewis has indicated that disclosure by a company of early efforts it is taking to meet the standards of the final clawback rules may help mitigate the advisory firm's concerns.
- **Short-Term and Long-Term Incentives**: Companies should provide thorough discussion of how significant, material events (that would otherwise be excluded from performance results of selected metrics of incentive programs) were considered in compensation committees' decisions to exercise discretion or refrain from applying discretion over incentive pay outcomes. Glass Lewis may find the inclusion of this disclosure helpful when it considers concerns about the exercise or absence of committee discretion.
- **Company Responsiveness to Say-on-Pay**: Companies with low support levels for previous years' say-on-pay votes should provide robust disclosure, including the rationale for not implementing changes to decisions regarding pay that drove low support, and intentions going forward.

Recommended Next Steps

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

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

Looking ahead to 2023, companies that received say-on-pay results below the ISS and Glass Lewis review thresholds should consider enhancing disclosures of their shareholder engagement efforts in 2023 and the specific actions they took to address potential shareholder concerns. Companies that fail to conduct sufficient shareholder engagement efforts and to make these disclosures may receive negative voting recommendations from proxy advisory firms on say-on-pay proposals and compensation committee member reelection.

Recommended actions for such companies include the following:

- **Assess results of the most recent say-on-pay vote**. As part of this analysis, identify which shareholders were likely the dissenting shareholders and why.
- **Engage key company stakeholders by soliciting and documenting their perspectives on the company's compensation practices**. Analyze stakeholder feedback, determine recommended next steps and discuss findings with relevant internal stakeholders, such as the compensation committee and the board of directors.
- **Review ISS and Glass Lewis company-specific reports and guidance to determine the reason for their vote recommendations in 2022**. Carefully consider how shareholders and proxy advisory firms will react to planned compensation decisions for the remainder of the current fiscal year and recalibrate as necessary. For example, consider compensation for new hires, leadership transitions and any special one-time grants or other arrangements.
- **Determine and document which changes will be made to the company's compensation policies in response to shareholder feedback.**
- **Disclose specific shareholder engagement efforts and results in the 2023 proxy statement**. Such disclosures should include information about the shareholders engaged, such as the number of them, their level of ownership in the company and how the company engaged them. This disclosure should also reflect actions taken in response to shareholder concerns, such as a company's decision to offer more robust disclosures or to adjust certain compensation practices.

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

Say-on-Golden-Parachute Proposal Results

Say-on-golden-parachute votes historically have received lower support than annual say-on-pay votes, and this trend was even stronger in 2022. Average support for golden parachute proposals dropped from 76% in 2021 to 70% from January 1, 2022, through July 15, 2022.[44] ISS' negative vote recommendations rose from 37% in 2021 to 47% in 2022. Companies should beware of including single-trigger benefits (*i.e.*, automatic vesting upon a change in control) in their parachute proposals given that stakeholders cite single-trigger vesting as a primary concern, with tax gross-ups and performance awards vesting at maximum value as significant secondary concerns. Companies have historically also cited excessive cash payouts as a concern.

Equity Plan Proposal Results

Equity plans continue to be widely approved, with less than 1% of equity plan proposals at Russell 3000 companies receiving less than a majority vote in 2022 through September 2022.[45] Average support for 2022 equity plan proposals as of September 2022 was 89.3%, which was slightly higher than the 89.1% average support for equity plan proposals observed in September 2021.[46]

Most companies garner strong equity plan proposal support from shareholders, regardless of the say-on-pay results. As of September 2022, Russell 3000 companies with less than 70% approval in say-on-pay votes still received 86% support for equity plan proposals, a 1% increase from the 85% level of support for equity plan proposals observed in 2021.[47]

The threshold number of points to receive a favorable equity plan proposal recommendation from ISS is expected to remain at 57 points for the S&P 500 model, 55 points for the Russell 3000 model and 53 points for all other Equity Plan Scorecard (EPSC) models.[48] ISS did not make changes to the factors, weightings or passing scores for any of the EPSC models.

[44] See Willis Towers Watson's report "U.S. Executive Pay Votes — 2022 Proxy Season Review" (October 2022).

[45] See Semler Brossy's report "2022 Say on Pay & Proxy Results" (September 29, 2022). See also Semler Brossy's report "2021 Say on Pay & Proxy Results" (January 27, 2022).

[46] See Semler Brossy's report "2022 Say on Pay & Proxy Results" (September 29, 2022).

[47] See *id.*

[48] See ISS' FAQ "United States Equity Compensation Plans" (December 17, 2021).

ISS clarified how it will assess a company's clawback policy for EPSC purposes, noting that, to receive points, the clawback policy should authorize recovery upon a financial restatement and cover all or most equity-based compensation for all NEOs. A company will not receive credit for a clawback policy that only contains the limited requirements stipulated by the SOX, or if the company discloses that it will establish a clawback policy only after the finalization of applicable rules under the Dodd-Frank Act.

ISS also changed how it considers a company's burn rate in evaluating stock plans. Currently, ISS uses a three-year adjusted average burn rate, as a percentage of weighted average common shares outstanding, as a measure of the company's typical annual equity-based grant rate. ISS compares this rate to a benchmark for the company's industry/index. A company's three-year adjusted burn rate relative to that benchmark is a factor in the EPSC.[49]

For meetings on or after February 1, 2023, the EPSC burn rate factor will instead use a "Value-Adjusted Burn Rate" (VABR), with benchmarks calculated as the greater of:

- an industry-specific threshold based on three-year burn rates within the company's GICS group segmented by S&P 500, Russell 3000 index (less the S&P 500) and non-Russell 3000 index; and
- a de minimis threshold established separately for each of the S&P 500, the Russell 3000 index less the S&P 500, and the non-Russell 3000 index.

ISS noted that the VABR seeks to better approximate companies' equity grant rates through compensation plans by using more accurate measures for the value of equity-based awards. A company's annual VABR is calculated as follows:

> Annual Value – Adjusted Burn Rate = ((# of options * option's dollar value using a Black-Scholes model) + (# of full-value awards * stock price)) / (weighted average common shares * stock price).

The VABR is expected to replace the existing EPSC burn rate factor beginning with meetings on or after February 1, 2023, with additional information to be provided in ISS' updated FAQs expected in December 2022.

Other Proxy Advisory Firm Takeaways

ISS' methodology for evaluating whether nonemployee director (NED) pay is excessive is expected to continue to apply in 2023. Under such policy, ISS may issue adverse vote recommendations for board members responsible for approving/setting NED pay. Such recommendations could occur where ISS determines there is a recurring pattern (two or more consecutive years) of excessive director pay without disclosure of a compelling rationale for those prior years or other mitigating factors.

Each year, companies should consider whether to make any updates to the compensation benchmarking peers included in ISS' database. ISS uses these company-selected peers when it determines the peer group it will use for evaluating a company's compensation programs. This year, ISS will accept these updates through December 5, 2022.[50]

Prepare for 2023 Pay Ratio Disclosures

The year 2023 marks the sixth year that SEC rules require companies to disclose their pay ratios, which compare the annual total compensation of the median company employee to the annual total compensation of the CEO.[51] Companies can prepare for the mandatory pay ratio disclosures by considering the following:

- Can the same median employee be used this year, and, if not, what new factors should be considered when identifying the median employee?
- What else do companies need to know for 2023?

Determining Whether To Use the Same Median Employee

Under Regulation S-K Item 402(u), a company only needs to perform median employee calculations once every three years, unless it had a change in the employee population or compensation arrangements that could significantly affect the pay ratio. This requires companies to assess annually whether their workforce compositions or compensation arrangements have materially changed.

When selecting a median employee for pay ratio disclosures about compensation in fiscal year 2022, companies should consider the following:

- If the company has been using the same median employee for three years, the company will need to perform median employee calculations for fiscal year 2022.
- Other companies that were originally planning to feature the same median employee as last year should not do so if their employee populations or employee compensation arrangements significantly changed in the past year.

[49] ISS lists the burn rate benchmarks applicable for meetings on or after February 1, 2022, in the Appendix section of its FAQ; see *id.*

[50] See ISS' "Company Peer Group Feedback" (2022).

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

When selecting a median employee for pay ratio disclosures regarding fiscal year 2022, companies should carefully consider how to incorporate furloughed employees, if applicable.[52]

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

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

Even if a company uses the same median employee in its proxy statement filed in 2023 as the company used in 2022, it must disclose that it is using the same median employee and briefly describe the basis for its reasonable belief that no change occurred that would significantly affect the pay ratio.

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

- How has workforce composition evolved over the past year?
  - Review hiring, retention and promotion rates.
  - Consider the applicability of exceptions under the pay ratio rules:
    - Determine whether to incorporate employees from recent acquisitions or business combinations into the consistently applied compensation measure (CACM). For example, for the fiscal year in which a business combination or acquisition becomes effective, a company may exclude individuals that become its employees as the result of the business combination or acquisition, as long as the company discloses the approximate number of employees it is omitting and identifies the acquired business it is excluding.
    - Determine whether the de minimis exception applies within the context of the company's 2022 workforce composition. As described above, under this exception, non-U.S. employees may be disregarded if the excluded employees account for less than 5% of the company's total employees or if a country's data privacy laws make a company's reasonable efforts insufficient to comply with Item 402(u).
  - Analyze how the workforce used for the CACM is distributed across the pay scale and how the distribution has changed since last year.
- How have compensation policies changed in the past year compared to the workforce composition? For example, an across-the-board bonus that benefits all employees may not materially change the pay ratio, while new special commission pay limited to a company's sales team would do so.
- Have the median employee's circumstances changed since last year? Consider changes to the employee's title and job responsibilities alongside any changes to the structure and amount of the employee's compensation, factoring in the company's broader workforce composition. Additionally, if the median employee was terminated, companies must identify a new median employee.

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

[52] For information on how to incorporate furloughed employees into pay ratio calculations, see the section titled "Incorporate Lessons Learned From the 2020 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2021 Pay Ratio Disclosures — Prepare for 2021 Pay Ratio Disclosures" in our December 14, 2020, publication "Matters To Consider for the 2021 Annual Meeting and Reporting Season."

Confirm Timing of the Next Say-on-Frequency Vote

The SEC requires reporting companies to conduct a shareholder vote on the frequency of the say-on-pay vote every six years, known as "say-on-frequency" vote. The first year that the say-on-frequency vote was required was in 2011. Because many companies first provided shareholders the opportunity to cast a say-on-frequency vote in 2011, many included the nonbinding advisory vote again in 2017 proxy statements and anticipate doing so again in 2023. The 2023 proxy season will mark the third time such votes are required.

Although the say-on-frequency vote is nonbinding and advisory in nature, the proxy cards must provide shareholders the option to vote for one, two or three-year periods between say-on-pay votes or to abstain from voting. The company should also state on the cards the current voting frequency, that the shareholder vote is advisory in nature and nonbinding, and when the next scheduled say-on-pay vote will occur. Additionally, companies should also note that they are required to conduct a say-on-frequency vote every six years, even if a company is already conducting its say-on-pay vote annually and intends to continue such practice.

Companies that qualify under the SEC's proxy rules as "smaller reporting companies" were not required to hold their first say-on-frequency vote until 2013, which means the third say-on-frequency vote for such companies that held say-on-frequency votes last in 2019 will be required in 2025. Emerging growth companies are exempt from the say-on-pay and say-on-frequency votes.

Annual Frequency Remains Most Common

At the overwhelming majority of companies, shareholders voted in favor of an annual say-on-pay vote, and that frequency remains by far the most common. Data from the last two say-on-frequency votes (*i.e.*, 2011 and 2017) from Russell 3000 companies shows that 81% of companies adopted an annual say-on-pay frequency in 2011, whereas 91% of companies adopted an annual say-on-pay frequency in 2017.[53] Companies slightly favored triennial versus biennial frequency with 18% of companies adopting triennial say-on-pay frequency in 2011 and 8% of companies adopting triennial frequency in 2017. It is expected that companies, shareholders and institutional investors will continue to favor annual say-on-pay votes in 2023.

Form 8-K Filing Requirement

Within four days following the annual meeting of the shareholders, a company must file a Form 8-K disclosing the results of the say-on-frequency vote. The disclosure must state the number of votes cast for each of "one year," "two years," and "three years," as well as the number of abstentions. Although the say-on-frequency vote is advisory in nature, companies must also disclose the decision of the board of directors regarding the frequency of future say-on-pay votes in a Form 8-K filing. The SEC permits a company up to 150 calendar days after the annual shareholder meeting (but no later than 60 days prior to the deadline for shareholder proposals for the next year) to decide and disclose its decision on future say-on-frequency votes.

[53] See Willis Towers Watson's "Executive Compensation Bulletin: Preference for Annual Say-on-Pay Votes Grows — for Now" (August 2017).

Evaluate Hart-Scott-Rodino Act Implications on Executive Compensation

Officers and directors who hold at least $101 million in voting securities in their companies should consider the need to make Hart-Scott-Rodino (HSR) filings whenever they increase their holdings through an acquisition of voting securities.[54] A company's annual preparation of its beneficial ownership table provides a regular opportunity to assess whether any of its officers or directors may be approaching an HSR filing threshold, in which case consulting HSR counsel is highly recommended. Importantly, HSR counsel also can advise when exemptions are available to obviate the need to file notifications.

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

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

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

Generally, an "acquisition" can trigger a filing obligation.[55] For example, a filing requirement is not triggered solely by an increase in the value of an officer's holdings from $100 million to $105 million as a result of share price appreciation. However, if such officer subsequently wanted to exercise a stock option, an HSR obligation could be triggered.

The need for a filing is triggered whenever — after the acquisition of voting securities — an officer or director's holdings of voting securities in the company exceed an HSR filing threshold (the lowest of which is currently $101 million). Current holdings plus the proposed acquisition are considered to determine whether the threshold has been met.

Higher voting securities thresholds triggering additional HSR filings exist as well, with the next two currently fixed at $202 million and $1.0098 billion.[56]

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

[54] The HSR Act establishes a set of notification thresholds that are adjusted annually based on changes to the gross national product. The initial threshold for 2022 is $101 million and new thresholds will be established in the first quarter of 2023.

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

[56] See the Federal Trade Commission's "HSR Threshold Adjustments and Reportability for 2022" (February 11, 2022).

The Federal Trade Commission and the Department of Justice have historically followed an informal "one free bite at the apple" enforcement practice when it comes to certain missed HSR filings, meaning that, if an officer or director inadvertently failed to make a required HSR filing, that person should notify the agencies and submit a corrective filing detailing his or her previous acquisitions and how he or she plans to meet filing obligations in the future. This one "free bite" may address all prior missed filings that occurred before the corrective filing.

However, the Federal Trade Commission and the Department of Justice have been known to pursue enforcement actions and may impose material civil penalties of up to $46,517 per day[57] for each day of noncompliance if an executive officer or director subsequently fails to make a required HSR filing, even if such failure was truly inadvertent.[58] Therefore, officers and directors who have made corrective filings should be especially vigilant and consult HSR counsel regularly before a potential subsequent "acquisition" event is expected to occur.

[57] The Federal Trade Commission is required by the Federal Civil Penalties Inflation Adjustment Act, as amended, to adjust the HSR civil penalty amount for inflation in January of each year based on the percentage change in the consumer price index. The maximum civil penalty for an HSR violation in 2022 is $46,517 per day and the new maximum will be established in January 2023.

[58] See the Federal Trade Commission's press releases "FTC Fines Capital One CEO Richard Fairbank for Repeatedly Violating Antitrust Laws" (September 2, 2021) and "FTC Fines Clarence L. Werner, Founder of the Truckload Carrier Werner Enterprises, Inc. for Repeatedly Violating Antitrust Laws" (December 22, 2021).

Prepare for Final Clawback Rules Under Dodd-Frank

On October 26, 2022, the SEC adopted long-awaited final rules implementing the incentive-based compensation recovery (clawback) provisions of the Dodd-Frank Act.[59] The final rules direct the stock exchanges to establish listing standards requiring listed companies to develop and implement policies providing for the recovery of erroneously awarded incentive-based compensation received by current or former executive officers and to satisfy related disclosure obligations.

The final rules largely track the proposed rules originally released in July of 2015, although (as described below) there are some important differences to understand, especially when evaluating existing clawback policies that were designed to comply with the proposed rules. For example, even some "little r" restatements that did not involve a material misstatement in past years may trigger a clawback under the final rules. The new rules also require more detailed disclosures about how a company's policy was implemented in the most recent fiscal period.

Clawback Policy Requirements: Listed companies will be required to adopt a clawback policy providing for recovery of incentive-based compensation erroneously received by current or former executive officers during the three completed fiscal years immediately preceding the year in which the company is required to prepare an accounting restatement due to material noncompliance with financial reporting requirements. Erroneous payments must be recovered even if there was no misconduct or failure of oversight on the part an individual executive officer.

Listed companies will be required to (i) file their written clawback policies as exhibits to their annual reports, (ii) indicate by checkboxes on the cover pages of their annual reports whether the financial statements included in the filings reflect a correction of an error to previously issued financial statements and whether any of those error corrections are restatements requiring a recovery analysis of incentive-based compensation under their clawback policies and (iii) disclose how they have applied their clawback policies during or after the last completed fiscal year.

Under the new rules, a company could be subject to delisting if it does not adopt a clawback policy that complies with the applicable listing standard, disclose the clawback policy and any application of the policy in accordance with SEC rules or enforce the clawback policy's recovery provisions.

Issuers Subject to the Final Rules: Almost all listed companies (including foreign private issuers, controlled companies, smaller reporting companies and emerging growth companies, but excluding certain registered investment companies) are subject to the final rules. While many commenters raised concerns about the potential difficulties that the final rules would impose on foreign private issuers, the SEC was unpersuaded. The only exempted listed companies under the final rules are issuers of security futures products, standardized options, unit investment trust securities and certain registered investment company securities.

Covered Executive Officers: The final rules adopt the same definition of "executive officers" used to determine a listed company's officers under Exchange Act Rule 16a-1 (for domestic issuers, the "Section 16 officers"). These executive officers, including former executive officers who are no longer serving at the time the clawback is required, are subject to the clawback requirements without regard to any individual knowledge or responsibility related to the restatement or the mistaken payments.

[59] See the SEC's final rule "Listing Standards for Recovery of Erroneously Awarded Compensation" (October 26, 2022) and press release "SEC Adopts Compensation Recovery Listing Standards and Disclosure Rules" (October 26, 2022).

However, in a change from the proposed rules, the final rules do not require recovery of incentive-based compensation (i) where the compensation was received by a person before beginning service as an executive officer or (ii) if that person did not serve as an executive officer at any time during the three-year look-back period to which the clawback rules apply.

Triggering Events: A triggering event will commence application of the clawback policy before an accounting restatement is actually filed. The three-year look-back period starts on the earlier of (i) the date the company's board of directors, committee and/or management concludes (or reasonably should have concluded) that a restatement is required or (ii) the date a regulator, court or other legally authorized entity directs the company to restate previously issued financial statements.

Covered Accounting Restatements: The final rules require that both "Big R" and "little r" accounting restatements trigger the clawback policy. A "Big R" restatement occurs when a company is required to prepare an accounting restatement that corrects an error in previously issued financial statements that is material to those previously issued financial statements. A "Big R" restatement requires the company to file an Item 4.02 Form 8-K and to amend its filings promptly to restate the previously issued financial statements. By contrast, a "little r" restatement corrects an error that would result in a material misstatement if the error were not corrected in the current period or was corrected in the current period and generally does not require Form 8-K filing.

The SEC provides the following example of a "little r" restatement: Assume that an improper expense accrual (such as an overstated liability) has accumulated over five years at $20 per year. Upon identification of the error in year five, the company evaluated the misstatement as being immaterial to the financial statements in years one through four (at only $20 per year). To correct the overstated liability in year five, a $100 credit to the statement of comprehensive income would be necessary, and $80 of this credit would relate to the previously issued financial statements for years one through four.

During the preparation of its annual financial statements for year five, the company determines that, although a $20 annual misstatement of expense would not be material to year five, the adjustment to correct the $80 cumulative error from previously issued financial statements would be material to comprehensive income for year five. Accordingly, instead of correcting the full $100 error in year five (which would result in a material misstatement if the error was corrected in the current period) or not correcting the error at all (which would result in a material misstatement if the error was not corrected in the current period), the company must correct the financial statements for years one through four to the extent they appear in the current filing for year five.

The SEC noted in the adopting release that its estimates reflect that "little r" restatements may be roughly three times as common as "Big R" restatements. The 2015 proposed rules provided that only a "Big R" restatement triggered a clawback, and many companies that proactively adopted clawback policies based on the proposed rules will need to incorporate into their existing policies "little r" restatements as triggering events to apply clawback protocols.

Recovery of Erroneously Awarded Incentive-Based Compensation: The final rules require that clawback policies provide for recovery of "incentive-based compensation," defined as "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of a financial reporting measure." "Financial reporting measures" may include both GAAP and non-GAAP financial measures, including stock price and TSR metrics. Awards based solely on continued employment do not need to be subject to clawback under the policy.

The amount of compensation subject to recovery ("erroneously awarded") is the excess of:

- the incentive-based compensation actually paid during the fiscal period when the applicable financial reporting measure is attained; over
- the amount that would have been received had the financial statements been correct in the first instance.

Examples of compensation that do not meet the definition of "incentive-based compensation" for purposes of the final rules include, but are not limited to:

- salaries;
- bonuses paid solely at the discretion of the compensation committee or the board of directors that are not paid from a "bonus pool" that is determined by achieving a financial reporting measure;
- bonuses paid solely upon satisfying one or more subjective standards and/or completion of a specified employment period;
- nonequity incentive plan awards earned solely upon satisfying one or more strategic measures (*e.g.*, consummating a merger or divestiture) or operational measures (*e.g.*, opening a specified number of stores, completing a project, increasing market share); and

- equity awards for which the grant is not contingent upon achieving any financial reporting measure and vesting is contingent solely upon completion of a specified employment period and/or attaining one or more nonfinancial reporting measures (*e.g.*, discretionary grants of time-vesting restricted stock, restricted stock units or stock options).

When Incentive-Based Compensation Is "Received": Incentive-based compensation will be deemed "received" for purposes of the clawback policy requirements in the fiscal period during which the financial reporting measure is attained, even if the payment or grant occurs after the end of that period. The date the compensation is "received" depends upon the terms of the award.

For example:

- If the grant of an award is based on satisfaction of a financial reporting measure, the award will be deemed received in the fiscal period when that measure was satisfied.
- A nonequity incentive plan award will be deemed received in the fiscal year that the executive officer earns the award based on satisfaction of the relevant financial reporting measure, rather than a subsequent date on which the award was paid.
- A cash award earned upon satisfaction of a financial reporting measure will be deemed received in the fiscal period when that measure is satisfied.

Exceptions to Recovery: The new listing standards provide for limited exceptions to the company's obligation to enforce the application of the clawback policy due to impracticability of such recovery. These exceptions are only available where:

- pursuing such recovery would be impracticable because the direct expense paid to a third party to assist in enforcing the policy would exceed the recoverable amounts and the issuer has (a) made a reasonable attempt to recover such amounts and (b) provided documentation of such attempts to recover to that company's applicable listing exchange;
- pursuing such recovery would violate the listed company's home country laws and the company provides to the exchange an opinion of counsel to that effect; or
- recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the registrant, to fail to meet the requirements of the Internal Revenue Code.

Restrictions on Indemnification and Insurance: The new rules prohibit listed companies from indemnifying or reimbursing any current or former executive officer against the recovery of erroneously awarded compensation. The rules also prohibit companies from paying the premiums on an insurance policy that would cover an executive officer's potential clawback obligations.

New Disclosure Requirements: The final rules include new disclosure requirements regarding how the clawback policy is implemented, during or following the end of the most recently completed fiscal year, including a requirement to provide:

- the date on which the listed issuer was required to prepare an accounting restatement and the aggregate dollar amount of erroneously awarded incentive-based compensation attributable to such accounting restatement;
- the aggregate amount of incentive-based compensation that was erroneously awarded to all current and former NEOs that remains outstanding at the end of the last completed fiscal year;
- any outstanding amounts due from any current or former executive officer for 180 days or more, separately identified for each named executive officer (or, if the amount of such erroneously awarded incentive compensation has not yet been determined as of the time of the report, disclosure of this fact and an explanation of the reasons why); and
- if recovery would be impracticable, for each current and former named executive officer and for all other current and former executive officers as a group, the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery.

Such disclosure will be required as part of the executive compensation disclosure provisions in new Item 402(w) of Regulation S-K (or analogous disclosure provisions in the forms applicable to foreign private issuers and listed funds). Note that, if an amount is properly determined to be not recoverable due to impracticality, such amount will not be considered to be outstanding at the last fiscal year for purposes of the disclosure requirements described above.

Companies must also incorporate any recoupment of compensation into the amounts shown for the year of recoupment in the Summary Compensation Table by subtracting the amount recovered from the amounts reported in the Summary Compensation Table for that year and quantify the amount recovered in a footnote.

New Exhibit Filing; XBRL: The new rules will require companies to file their clawback policies as exhibits to the annual reports on Form 10-K, 20-F or 40-F. The new disclosure on the cover page of the Form 10-K, 20-F or 40-F, as applicable, and Item 402(w) with respect to domestic companies, must be tagged in interactive block text tag format using eXtensible Business Reporting Language.

Effects on Existing Clawback Rules: CEOs and CFOs remain subject to the clawback provisions of SOX, which provide that if a company is required to prepare an accounting restatement because of "misconduct," the CEO and CFO are required to reimburse the company for any incentive or equity-based compensation and profits from selling company securities received during the year following issuance of the inaccurate financial statements. To the extent that the Dodd-Frank Act clawback policy and SOX cover the same recoverable compensation, the CEO or CFO would not be subject to duplicative reimbursement. Recovery under the new rules will not preclude recovery under SOX to the extent any applicable amounts have not been reimbursed to the issuer.

When the New Rules Take Effect: The SEC's final rules were published in the Federal Register on November 28, 2022, and will become effective on January 27, 2023. The stock exchanges have up to 90 days after publication to propose new listing standards, and those only need to become effective within one year following the publication date.

Following the effective date of the new listing standards, listed companies will have 60 days to adopt the required clawback policy. A listed company must recover all erroneously awarded incentive-based compensation that is received on or after the effective date of the applicable listing standard.

What Companies Should Do Now: Listed companies that will be subject to the new requirements should consider the following actions:

- Review existing clawback policies to consider what changes may be required, particularly given the additional requirements imposed since the 2015 proposed regulations. Note, however, that companies may want to wait for the stock exchanges to release their implementing listing standards (which could be broader than the SEC requirements) before actually adopting or amending clawback policies to comply with the new rules.
- Start considering which aspects of the compensation plan to review and possibly supplement in light of the clawback mandate.
- Review executive officer determinations in light of the new significance of this designation.

Monitor Form S-8 Share Issuance Capacity

Companies should be mindful to monitor the number of shares available for sale under their Form(s) S-8. As discussed below, the impact of share recycling provisions found in many equity compensation plans can obscure the number of shares available for sale under a Form S-8.

When companies register on Form S-8 the sale of securities under an equity compensation plan, a fixed number of securities is registered for sale. Other than automatic adjustments tied to stock splits, dividends and certain anti-dilution provisions, that fixed number of registered securities cannot be increased without filing a new Form S-8. For purposes of keeping track of the finite capacity available under an effective Form S-8, each share associated with a compensatory award should be deducted from the total number of shares available for issuance under the Form S-8 at the time the sale of the securities occurs. In the case of full value awards such as restricted stock, restricted stock units and performance stock units, the sale occurs at grant, whereas in the case of employee stock options and stock appreciation rights, the sale occurs upon exercise of the subject award. Shares that are deemed sold must be deducted from the available capacity at the time of sale. The shares cannot be added back to the total number of shares available for issuance under the Form S-8 even if those shares are later forfeited back to the company by the grantee and revert to the equity incentive plan.

Impact of Share Recycling

Many equity incentive plans allow for share recycling under certain conditions so that shares subject to awards granted under the plan that are subsequently forfeited or surrendered revert to and replenish the share reserve available under the plan. These share recycling provisions can result in a discrepancy between the number of registered securities available for sale under the Form S-8 and the number of authorized securities available under the subject employee compensation plan.

Recommended Steps

Companies should consider separately tracking the number of registered securities available for sale under the Form S-8 and the number of authorized securities available under the subject employee compensation plan to ensure that a company does not inadvertently grant equity awards under its equity compensation plan when the Form S-8 no longer has a sufficient number of registered shares available for issuance.

Consider New DGCL Amendments Permitting Officer Exculpation

Effective August 1, 2022, Section 102(b)(7) of the Delaware General Corporation Law (DGCL) was amended to authorize exculpation of certain senior officers of Delaware corporations from personal liability for monetary damages in connection with breaches of their fiduciary duty of care (the Officer Exculpation Amendment).

Explanation of the Officer Exculpation Amendment

Since its original adoption in 1986, Section 102(b)(7) of the DGCL has authorized exculpation of directors of Delaware corporations from personal liability for monetary damages in connection with breaches of their fiduciary duty of care. However, until the recent enactment of the Officer Exculpation Amendment, officers of Delaware corporations were not afforded the same protection — despite often having overlapping roles and, in recent years, being susceptible to similar lawsuits. The Officer Exculpation Amendment reduces the differential treatment between directors and officers, but Section 102(b)(7) imposes additional limitations on exculpating senior officers from liability.

Now Delaware corporations may include provisions in their certificates of incorporation that limit or eliminate the personal liability of certain enumerated officers.[60] As is the case with director exculpation, officer exculpation is limited to instances in which a breach of the fiduciary duty of care has occurred. Exculpation from liability is not available under the DGCL to directors or officers for breaches of their duty of loyalty or for "acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law," among other exclusions.

An important difference between officer and director exculpation under the DGCL is that officer exculpation is not permitted in connection with claims brought by or in the right of the corporation, including stockholder derivative claims, while director exculpation under the DGCL is not subject to that limitation.

In order to afford senior officers with the protection from personal liability afforded by exculpation under Section 102(b)(7), Delaware corporations must "opt in" to the law's coverage by including an exculpation clause in their original certificates of incorporation or by adopting an amendment to their certificates of incorporation.[61] Pursuant to Section 242(b) of the DGCL, in order to amend a corporation's certificate of incorporation, its board of directors must approve the amendment, declare its advisability and submit the amendment to a vote of stockholders at an annual or special meeting of stockholders. Adoption of such amendment requires the affirmative vote of holders of a majority of the outstanding shares of stock entitled to vote on the proposed amendment (unless a greater number of votes, or any separate class or series of votes, is required to amend the corporation's certificate of incorporation pursuant to the terms thereof).[62]

[60] These enumerated officers include persons who at the time of an act of omission to which liability is asserted are deemed to have consented to service by the delivery of process to the registered agent of the corporation pursuant to Section 3114(b) of the DGCL. This includes any person who (i) is or was the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer of the corporation, (ii) is or was identified in the corporation's Summary Compensation Table included in the corporation's proxy statement or annual report on the corporation's Form 10-K or (iii) has, by written agreement with the corporation, consented to be identified as an officer for purposes of accepting service of process.

[61] A proposal to amend the certificate of incorporation to include officer exculpation will require a preliminary proxy filing. Companies should consider and incorporate such preliminary proxy filing in their timelines for their 2023 annual meeting filings.

[62] In two instances, the corporations' stockholders failed to approve the officer exculpation amendment, due primarily to each corporation having a supermajority voting requirement and a significant number of retail stockholders that did not vote on the amendment proposal.

Proxy Advisor Response

Although the Officer Exculpation Amendment was adopted just several months ago, at least eleven corporations have filed proxy statements in that time seeking stockholder approval to amend their certificates of incorporation to include an officer exculpation clause. Although preliminary indications suggest that ISS and Glass Lewis have viewed officer exculpation amendments as generally acceptable, as described below, that may not be the case for Glass Lewis in all cases going forward. In issuing voting recommendations to date, neither ISS nor Glass Lewis has expressed any material concerns or made any adverse voting recommendations specifically addressing officer exculpation proposals (or made adverse voting recommendations in the reelection of directors who have approved such exculpation proposals).

The first two publicly filed proxy statements seeking stockholder approval of officer exculpation amendments were put forth as part of a "bundled" package proposal where stockholders were asked to vote either "for" or "against" a number of changes to the corporations' certificates of incorporation in their entirety, rather than on each individual amendment. In both instances, ISS and Glass Lewis did not explicitly take a position with respect to the officer exculpation amendment, focusing instead on the aggregate impact of the "bundled" amendments on stockholder rights. In one instance, Glass Lewis recommended a vote "against" the proposal bundling amendments to the certificate of incorporation, noting that the practice of bundling several amendments into a single proposal "negatively impacts the ability of shareholders to judge each amendment on its own merits."

Nine corporations have subsequently put forth stand-alone proposals to amend the certificate of incorporation to include officer exculpation provisions. Of those nine, proxy advisor recommendations are available in six instances as of the date of this writing, and in all six cases, both ISS and Glass Lewis have specifically recommended that stockholders vote "for" the officer exculpation amendments. Glass Lewis noted that such amendments will not "have a negative impact on shareholders" and ISS echoed this outlook.

These favorable recommendations highlight the importance of separating proposals for stockholder approval of officer exculpation clauses from other proposals to enhance the likelihood that such proposals receive a favorable recommendation and ultimately obtain stockholder approval.

On November 4, 2022, ISS proposed amendments to its benchmark voting policy for 2023 to "[g]enerally vote for proposals providing for exculpation provisions in a company's charter to the extent permitted under applicable state law." ISS cited the Officer Exculpation Amendment as the rationale for this proposed policy update. ISS is expected to publish its final policy updates for the coming year in December 2022, although final updates commonly vary from the proposed updates.

Despite its lack of adverse voting recommendations on officer exculpation proposals thus far, Glass Lewis' recently adopted 2023 policy guidelines, which are effective for annual meetings in 2023, state that Glass Lewis "will closely evaluate proposals to adopt officer exculpation provisions on a case-by-case basis [and] generally recommend voting against [officer exculpation] proposals eliminating monetary liability for breaches of the duty of care for certain corporate officers, unless compelling rationale for the adoption is provided by the board, and the provisions are reasonable."

Additional Legal Considerations

To date, two separate complaints have been filed in Delaware Chancery Court challenging the adoption by two separate issuers of an amendment to their certificates of incorporation implementing an officer exculpation clause. Both lawsuits relate to whether a class of nonvoting shares is entitled to vote on officer exculpation amendments and seek to invalidate the amendment.

Next Step: Proposing and Adopting a Certificate of Incorporation Amendment

Corporations wishing to adopt an amendment to their certificates of incorporation to include officer exculpation should consult counsel to consider the related requirements, legal considerations and implications involved. Corporations should also consider working with counsel to conduct a holistic governance review to ensure their governing documents align with the most recent market standards and trends and with those of their peers.

Consider Universal Proxy Rules

In November 2021, the SEC adopted amendments to the proxy rules to mandate that companies use universal proxy cards in contested elections, which permit shareholders to "mix and match" from competing slates of candidates without having to attend the shareholder meeting.[63] Under the new rules, companies and dissidents must list on their proxy cards all duly nominated director candidates, including the board's nominees, any dissident's nominees and any proxy access nominees.[64] Previously, shareholders generally had to choose between voting for the company's slate on the company's proxy card or the activist's slate on the activist's proxy card.

Key Action Items

Companies should address the following matters:

Nominee consent. Director nominees must consent to be named in any proxy statement — not just the company's — relating to the shareholder meeting at which directors will be elected. Companies should consider revising the consent language in their bylaw provisions regarding advance notice and proxy access and their D&O questionnaires to ensure that nominees are required to give the necessary consents.

Notice. A dissident shareholder seeking to run an election contest is required to provide notice to the company not later than 60 calendar days prior to the anniversary date[65] of the previous year's annual meeting. This notice requirement is in addition to any notice or other requirements in a company's governing documents, and generally the SEC notice requirement is later than the notice required under a company's advance notice bylaws. Companies without an advance notice bylaw should consider adopting one, and companies with a bylaw that provides for a notice period of 60 days or less in advance of the anniversary of the meeting date may want to consider amending the bylaw to provide for additional notice.

In addition, a company receiving a notice from a dissident is required to notify the dissident of the names of the company's nominees no later than 50 calendar days prior to the anniversary date of the previous year's annual meeting.

Dissident proxy statements. A dissident must file its definitive proxy statement at least 25 calendar days before the shareholder meeting or five calendar days after the company files its definitive proxy statement, whichever is later, and include disclosure concerning the dissident's intent to solicit holders of at least 67% of the voting power entitled to vote in the election of directors. A dissident's failure to timely file its proxy statement will preclude it from soliciting proxies, and the company has the option to disseminate a new proxy card with only the company's nominees (and, if applicable, any proxy access nominees).

Company proxy statements. Companies must disclose in their proxy statements — for contested and uncontested elections — the deadline for receiving notice of a dissident's nominees under the universal proxy rules.

[63] See our November 19, 2021, client alert "SEC Mandates Universal Proxy Cards in Election Contests."

[64] The new rules do not apply to elections held by registered investment companies and business development companies.

[65] There is a provision for adjusting the deadline if there was no previous annual meeting or the date of the meeting has changed by more than 30 days from the previous year. This adjustment is also applicable to the related notice requirement imposed on companies.

Company and dissident proxy cards. The proxy cards for a contested election that companies and dissidents are required to provide shareholders must:

- list the names of all duly nominated nominees, clearly distinguishing between company nominees, dissident nominees and proxy access nominees, alphabetically listing the nominees within each group;
- use the same font type, style and size for all nominees presented on the card;
- prominently disclose the maximum number of nominees for which authority to vote can be granted; and
- prominently disclose how a proxy will be treated if it is cast for more or less than the number of directors to be elected, or if the proxy does not provide a direction.

Bylaw amendments. The universal proxy rules do not contain an enforcement mechanism for a dissident's failure to comply. Accordingly, companies should consider amending their bylaws so that failure to comply with these rules renders a dissident's nominees ineligible for election under the bylaws.

Potential Impact of the Universal Proxy Rules

The impact of mandated universal proxy cards is unclear. Potential impacts, however, include the following:

- Because shareholders can more easily vote for a mix of company and dissident nominees, activists may be more likely to win at least one board seat in a contested election.
- Given the focus on individual nominees, as opposed to management and dissident slates as a whole, management's individual nominees may be more closely scrutinized.
- Proxy advisors may begin issuing recommendations supporting a mix of candidates from management and dissident slates.
- "Nominal" proxy contests — in which dissidents incur minimal costs to pursue a contest with no intention of gaining a board seat, such as to gain leverage in negotiations with the company — may increase.

Companies should evaluate their proxy disclosure to ensure they are effectively conveying the skills and attributes that each of their nominees bring to the board room.

Revisit Board Leadership and Risk Oversight Disclosures

Recent SEC staff comment letters have requested enhanced proxy statement disclosures by companies regarding board leadership structure and risk oversight. The staff has issued comments to a cross section of companies from different industries, without regard to the leadership structure selected by the company. The staff issued a different mix of the following comments as applicable to each company:

- Please expand your discussion of the reasons you believe that your leadership structure is appropriate, addressing your specific characteristics or circumstances. In your discussion, please also address the circumstances under which you would consider having the chair and CEO roles filled by a single individual, when shareholders would be notified of any such change and whether you will seek prior input from shareholders. Please also disclose how the experience of your lead independent director is brought to bear in connection with your board's role in risk oversight.
- Please expand upon the role that your lead independent director plays in the leadership of the board. For example, please enhance your disclosure to address whether or not your lead independent director may:
  - represent the board in communications with shareholders and other stakeholders;
  - require board consideration of, and/or override your CEO on, any risk matters; or
  - provide input on design of the board itself.
- Please expand upon how your board administers its risk oversight function. For example, please disclose:
  - why your board elected to retain direct oversight responsibility for strategic risks and other risk areas not delegated to a committee, including cybersecurity matters, rather than assign oversight to a board committee;
  - the timeframe over which you evaluate risks (*e.g.*, short-term, intermediate-term or long-term) and how you apply different oversight standards based upon the immediacy of the risk assessed;
  - whether you consult with outside advisors and experts to anticipate future threats and trends, and how often you reassess your risk environment;
  - how the board interacts with management to address existing risks and identify significant emerging risks;
  - whether you have a chief compliance officer and to whom this position reports; and
  - how your risk oversight process aligns with your disclosure controls and procedures.

The SEC staff's issuance of these comments reflects its view that the disclosures provided in response to Item 407(h) of Regulation S-K have become increasingly standardized and are not tailored to provide meaningful information to investors.

Notably, the SEC staff issued these comments on a prospective basis, asking companies to confirm in their response letters that they will enhance their disclosures in the future. The comments do not require companies to amend their past filings, and the SEC staff noted that it is not seeking to review proposed disclosures in response to these comments.

Companies should consider proactively enhancing their board leadership structure and risk oversight disclosures in their 2023 proxy statements to provide more company-specific detail about the board's role in risk oversight and the relationship between the board's leadership structure and risk management matters. We also recommend that companies consider the 2009 adopting release for Item 407(h) of Regulation S-K for helpful guidance when preparing disclosures regarding board leadership structure and risk oversight. Companies should remain mindful that the SEC's expected new disclosure rules for climate change and cybersecurity matters will likely mandate enhanced disclosures relating to board oversight of climate-related risks and cybersecurity risks.[66]

[66] For further background and discussion on the SEC's proposed rules on disclosures relating to board oversight of climate-related risks and cybersecurity risks, see our client alerts "SEC Proposes New Rules for Climate-Related Disclosures" (March 24, 2022) and "SEC Proposes New Rules for Cybersecurity Risk Management, Strategy, Governance and Incident Disclosure" (March 11, 2022).

Consider Recommendations To Increase Board Diversity and Expertise and Enhance Related Disclosures

Board diversity is expected to continue to be, and climate and cybersecurity expertise are expected to newly be, significant focus areas for the upcoming 2023 proxy season. Companies should consider proactively taking steps to comply with applicable board diversity disclosure rules and investor requests to increase diversity in the boardroom. In addition to board diversity, boards should more broadly assess their composition and skills to determine whether the board already has or may consider adding directors with expertise in climate-related risk and cybersecurity risk. As discussed in more detail in the section of this guide titled "Note the Status of Recent and Pending SEC Rulemakings," the SEC's proposed rules regarding cybersecurity and climate-related matters are not yet final, giving companies time to consider enhancing disclosure regarding board expertise in these areas.

Sustained Focus on Board Diversity

Companies should continue to be mindful of investor expectations related to board diversity, including investor voting policies and proxy advisory firm guidelines. For example, in January 2022, State Street Global Advisors (SSGA) CEO Cyrus Taraporevala announced in his annual letter to board chairs primary stewardship priorities for 2022, including a focus on the diversity of boards and workforces. SSGA concurrently published updated guidance on enhancing gender, racial and ethnic diversity disclosures and reinforcing last year's voting policies relating to diversity disclosures. SSGA will continue to vote against the chair of the nominating and governance committee at S&P 500 and FTSE 100 companies that do not (i) disclose the racial and ethnic composition of their boards and (ii) have at least one director from an underrepresented community on the board. In 2022, SSGA implemented a voting policy expecting boards of companies in all markets and indices to have at least one female board member. Beginning in the 2023 proxy season, SSGA will expect companies in the Russell 3000, TSX, FTSE 350, STOXX 600 and ASX 300 indices to have boards comprised of at least 30% women directors. SSGA may waive the policy if a company engages with SSGA and provides a specific, timebound plan for reaching 30% representation of women directors.

Similarly, in 2021, Vanguard funds began voting against directors, including nominating committee chairs, at companies where progress on board diversity fell behind market norms and expectations.

Fidelity International highlighted in its July 2022 sustainable investing report that improving board diversity remains a priority. Fidelity generally will continue, in certain markets that include the U.S., the U.K. and the EU, to vote against reelection of directors at companies where women comprise less than 30% of the boards of directors.

As discussed in the section of this guide titled "Assess the Impact of Proxy Advisory Voting Guidelines by ISS and Glass Lewis," ISS has proposed to generally recommend against the chair of the nominating committee (or other directors on a case-by-case basis) at a company with no women on the board of directors. ISS would make an exception if there was at least one woman on the board at the preceding annual meeting and the board makes a firm commitment to return to a gender-diverse status within a year. A one-year grace period would apply to companies that have no women on their boards but have at least one director who is disclosed as identifying as nonbinary. Beginning in 2023 for Russell 3000 companies, Glass Lewis will generally recommend against the chair of the nominating committee of a board where less than 30% of the board features gender diversity. For companies outside the Russell 3000 index, Glass Lewis' existing policy requiring a minimum of one gender-diverse director will remain in place. Additionally, beginning in 2023 for Russell 1000 companies, Glass Lewis will generally recommend against the chair of the nominating committee of a board without a director from an underrepresented community.

Diversity Disclosure Trends

While the SEC's Spring 2022 rulemaking agenda anticipates new disclosure rules related to corporate board diversity, the SEC has not yet issued any proposed rules. Nonetheless, in 2022, many companies voluntarily expanded their public disclosures related to board diversity, and companies are increasingly using their proxy statements to provide investors with more clarity on how diversity, equity and inclusion matters are addressed. In 2022, approximately 93% of S&P 500 companies disclosed the racial or ethnic composition of their boards, compared to 60% in 2021.[67] Approximately 34% of Russell 3000 companies provided such disclosure in 2022, an increase compared to the prior year.[68] This reporting trend is expected to continue in the upcoming proxy season given the sustained investor focus on board diversity and the implementation of the Nasdaq rules discussed below.

Nasdaq Board Diversity Rules

In 2022, Nasdaq-listed companies became subject to two new requirements: (i) making annual public disclosure of board-level diversity statistics using a standardized matrix template under Nasdaq Rule 5606 and (ii) complying with, or disclosing why they do not have, board diversity objectives under Nasdaq Rule 5605(f).

Board Diversity Matrix: Nasdaq-listed companies are required to disclose, following a standardized matrix format, the number of directors who self-identify according to specified categories, including gender, race/ethnicity and LGBTQ+ status. Many companies solicited this information, as well as individual consent to use of such information in company disclosures, from directors and nominees through the annual D&O questionnaire process.[69] Each Nasdaq-listed company should continue to include the required matrix disclosure in its proxy statement, annual report on Form 10-K or Form 20-F, as applicable, or on the company's website.[70]

Comply or Explain Requirement: Nasdaq Rule 5605(f) requires companies to meet specified board diversity objectives or otherwise explain the company's reasons for not meeting such objectives. Subject to limited exemptions and transition periods, companies will be required to have, or explain why they do not have, one diverse director by December 31, 2023, and two diverse directors by December 31, 2025 or 2026, depending on the listing tier.[71] Companies can reference Nasdaq's related FAQs to understand and assess compliance with the new rules.

Legal Challenges to New Rules: In 2021, shortly after the SEC issued a final order approving the Nasdaq proposed rule requiring board diversity, the Alliance for Fair Board Recruitment filed a petition for review in the Fifth U.S. Circuit Court of Appeals, arguing that Nasdaq Rule 5605(f) is unconstitutional because it will compel companies to unlawfully discriminate on the basis of gender, race and sexual orientation when selecting directors. The plaintiffs claim that the SEC's approval of this rule exceeds the agency's authority under federal securities law and violated the Equal Protection Clause of the U.S. Constitution and federal anti-discrimination laws.[72] The SEC has argued that the government has no role in enforcing the rule, and therefore, the rule's constitutionality is not in question. The Fifth Circuit heard oral arguments on August 29, 2022, and the outcome of the suit remains to be seen.[73] Given the legal uncertainty surrounding Nasdaq's board diversity disclosure requirements, companies should continue to comply with Nasdaq rules and monitor legal challenges moving forward.

State Diversity Laws

Companies may be subject to additional state law-based board diversity requirements and should confirm applicability of those.[74] However, some states may be deterred from enforcing such requirements after two state courts deemed California's

[67] See the 2022 U.S. Spencer Stuart Board Index.

[68] See The Conference Board/ESGAUGE Corporate Board Practices in the Russell 3000, S&P 500, and S&P MidCap 400: Live Dashboard.

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

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

[71] On December 14, 2022, the SEC posted a notice of Nasdaq's proposed rule change to simplify the original August compliance deadlines to December 31.

[72] See our January 19, 2022, client alert "Rulings in 2022 Could Bring Clarity on California and Nasdaq Board Diversity Mandates."

[73] See *Alliance for Fair Board Recruitment v. SEC*, 5th U.S. Circuit Court of Appeals, No. 21-60626.

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

board diversity laws[75] unconstitutional under the state's equal protection clause.[76] The judge in each case enjoined the state from spending taxpayer money to implement or enforce the board diversity laws. However, on September 16, 2022, the appellate court in each case temporarily stayed each injunction to the extent it prevented the California secretary of state from collecting and reporting board diversity data. The temporary stays therefore enable the state to continue to collect diversity data on corporate disclosure forms pending the resolution of its appeal of the injunctions. The California secretary of state has appealed the state court decisions. Federal court proceedings challenging the same laws under the U.S. Constitution are currently on hold in the Ninth U.S. Circuit Court of Appeals until the outcome of the appeal of either state decision is determined. While legal proceedings related to state board diversity laws will likely continue, companies can continue to work toward achieving their board diversity goals.

Cybersecurity Board Expertise Disclosure

On March 9, 2022, the SEC proposed new rules on cybersecurity risk management, strategy, governance and incident disclosure.[77] The proposed rules would require disclosure about the cybersecurity expertise of members of the board of directors, including the names of relevant directors and a description of the nature of their expertise. Proposed Item 407(j)(1)(ii) includes the following nonexclusive list of criteria for determining cybersecurity expertise: (i) whether the director has prior cybersecurity work experience; (ii) whether the director has obtained a certification or degree in cybersecurity; and (iii) whether the director has knowledge, skills or other background in cybersecurity. Similar to the SEC's safe harbor for "audit committee financial experts," the proposed rules note that a person who is determined to have expertise in cybersecurity will not be deemed an expert for any purpose, including, without limitation, for purposes of Section 11 of the Securities Act of 1933, as a result of being designated or identified as a director with expertise in cybersecurity pursuant to proposed Item 407(j). Companies may use the time prior to issuance of the final rule to review and assess their boards' skills and experience and to consider enhancing related disclosures on cybersecurity expertise.

Climate-Related Board Oversight and Expertise Disclosure

On March 21, 2022, the SEC proposed new rules to enhance and standardize climate-related disclosures for investors.[78] The proposed rules would require companies to provide detailed disclosures, including identifying any board members or board committees responsible for the oversight of climate-related risks. The responsible board committee may be an existing committee, such as the audit committee or risk committee, or a separate committee established to focus on climate-related risks. The proposed rules would also require disclosure of whether any director has expertise in climate-related risks, "in sufficient detail to fully describe the nature of the expertise." While certain companies have provided climate-related risk disclosures in their proxy statements and annual reports in response to an increased focus by shareholders and other stakeholders on board oversight of risk, most companies will need to take additional time to prepare disclosures that include the level of detail required by the proposed rules. Companies may use the time prior to issuance of the final rule to review and assess their boards' skills, whether their boards have established committee oversight of climate-related risks and whether any board members have expertise in climate-related risk.

[75] AB 979, enacted in September 2020, required companies to have at least one director from an underrepresented community by the end of 2021 and two or three such directors by the end of 2022, depending on board size. In addition, a related California law enacted in 2018, SB 826, mandated that boards with five members have at least two female members and those with six or more members have at least three female members by December 2021. Both laws required companies to report compliance to the California secretary of state, who would be authorized to impose fines of $100,000 for a first-time violation and $300,000 for each subsequent violation.

[76] See our article in the *Harvard Law School Forum on Corporate Governance* "Recent Ruling on Board Diversification" (May 8, 2022).

[77] See our March 11, 2022, client alert "SEC Proposes New Rules for Cybersecurity Risk Management, Strategy, Governance and Incident Disclosure."

[78] See our March 24, 2022, client alert "SEC Proposes New Rules for Climate-Related Disclosures."

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

Proxy advisory firm ISS has proposed updates to its voting guidelines,[79] and Glass Lewis has updated its voting guidelines for the 2023 annual meeting season .[80] Companies should assess the potential impact of these updates when considering changes to their corporate governance practices, shareholder engagement and proxy statement disclosures.[81] Companies should also keep in mind that ISS often includes policy updates in its final voting policy that did not appear in the proposed updates.

Climate Change: ISS' proposed guidelines include an expansion of its policy on climate board accountability. The advisory firm introduced the policy in selective markets in 2022, including the U.S. and continental Europe, and will apply it globally under the proposed guidelines. ISS will also update the factors it considers when determining whether a company is adequately disclosing climate risks, such as according to the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).

Glass Lewis' updated ESG policies state that companies with material exposure to climate risk due to their operations should provide thorough climate-related disclosures in line with the recommendations of the TCFD, and the boards of such companies should have explicit and clearly defined oversight responsibilities for climate-related issues. If disclosure regarding these matters is absent or significantly lacking, Glass Lewis may recommend voting against company directors. In addition, Glass Lewis' updated voting guidelines provide that it will generally recommend voting against the governance committee chair of a Russell 1000 company that does not provide explicit disclosure, such as in the company's proxy statement and governing documents, concerning the board's role in overseeing environmental and social matters.

Board Gender Diversity: ISS currently will recommend voting against the chair of the nominating committee (or other directors as appropriate), with limited exceptions, of an all-male board of directors, unless the company has included proxy statement disclosure of a "firm commitment" to appoint at least one woman to the company's board within a year. Under the proposed guidelines, beginning on February 1, 2023, the policy will expand as applicable to companies beyond the Russell 3000 and S&P 1500 indices and include foreign private issuers. In addition, the proposed guidelines include a one-year grace period for a company to come into compliance where the board includes no women but does include at least one director who is disclosed as identifying as nonbinary.

As announced in its 2022 guidelines, in 2023, Glass Lewis will generally recommend voting against nominating committee chairs of boards of Russell 3000 companies that are not at least 30% gender-diverse. Depending on the circumstances, Glass Lewis may extend its voting recommendation to additional members of the nominating committee. In determining its recommendation, Glass Lewis will consider company disclosure of its diversity considerations and may refrain from recommending that shareholders vote against directors if the board has provided a sufficient rationale or plan to address its lack of diversity.

[79] See ISS' "Proposed ISS Benchmark Policy Changes for 2023" (November 4, 2022). ISS' final proxy voting guidelines for 2023 are expected to be released in early December 2022.

[80] See Glass Lewis' "2023 Policy Guidelines — United States" (November 18, 2022) and "2023 Policy Guidelines — ESG Initiatives" (November 18, 2022).

[81] For compensation-related updates regarding ISS and Glass Lewis' 2023 guidelines, see the section of this guide titled "Incorporate Lessons Learned From the 2022 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2023 Pay Ratio Disclosures."

Delaware Officer Exculpation Proposals:[82] In August 2022, the DGCL was amended to authorize the exculpation of officers in connection with direct claims brought by shareholders. In connection with the amendments, ISS' proposed guidelines state that ISS will generally recommend voting for proposals providing for exculpation provisions in a company's charter, including exculpation of some, but not all, officers.

Glass Lewis will evaluate proposals to adopt officer exculpation provisions on a case-by-case basis and will generally recommend voting against proposals eliminating monetary liability for breaches of the duty of care for certain corporate officers, unless the board provides a compelling rationale for eliminating the liability and the provisions are considered reasonable.

Politics and Lobbying Proposals: ISS' proposed guidelines provide that ISS generally will recommend voting on a case-by-case basis on proposals requesting greater disclosure of a company's alignment of political contributions, lobbying and electioneering spending with the company's publicly stated values and policies. In determining its recommendation, ISS will consider:

- the company's governance, oversight and disclosure related to direct political contributions, lobbying activities and payments to groups that may be used for political purposes;
- the company's disclosure regarding the reasons for its support of political candidates, trade associations or other political activities;
- incongruencies between the company's political expenditures and its publicly stated values and priorities; and
- recent significant controversies related to the company's lobbying, political contributions or political activities.

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

- ISS' proposed updates include a recommendation that shareholders vote against relevant directors at all U.S. companies with unequal voting rights.
- ISS' proposed updates also end the current one-year transition period delaying adverse vote recommendations against companies with capital structures that provide for unequal voting rights.
- For certain U.S. domestic issuers incorporated outside the U.S. and listed solely on a U.S. exchange, ISS would generally recommend voting for resolutions to authorize the issuance of common shares representing up to 20% of a company's currently issued common share capital if the issuance is not tied to a specific transaction or financing proposal.
- Glass Lewis will generally recommend against the chair of the nominating committee of a board of a Russell 1000 company (a) with fewer than one director from an underrepresented community or (b) that has not provided any disclosure regarding certain director diversity and skills matters.
- Glass Lewis revised its "overboarding" policy and will generally recommend against a director who serves as an executive officer (other than executive chair) of a public company while serving on more than one external public company board, a director who serves as an executive chair of any public company while serving on more than two external public company boards and any other director who serves on more than five public company boards.
- Glass Lewis may recommend against a company's nominating committee chair when the company's proxy statement does not identify the proponent or lead proponent of a shareholder proposal, and Glass Lewis' updated ESG guidelines encourage companies to provide information regarding proponents' share ownership levels and the companies' engagement with the proponents.
- Glass Lewis may recommend against relevant directors if a company experiences cyberattacks that cause significant harm to shareholders and the company has not provided clear disclosure concerning the role of the board in overseeing cybersecurity matters and how the company ensures that its directors are knowledgeable about such matters.

[82] For related updates, see the section of this guide titled "Consider New DGCL Amendments Permitting Officer Exculpation."

Note the Current Status of SEC Rules Governing Proxy Advisors

In July 2020, the SEC adopted amendments to its proxy rules that codified the SEC's position that voting advice issued by proxy advisors, such as ISS and Glass Lewis, generally constitutes a solicitation under the federal proxy rules and required certain conditions for proxy advisors to qualify for exemptions from the information and filing requirements under the proxy rules.[83]

Nearly two years later, in July 2022, the SEC, by a 3-2 vote, adopted amendments rescinding two components of the proxy rules adopted in 2020.[84] Specifically, the amendments rescinded certain conditions that proxy advisors would have to satisfy for their voting recommendations to be exempt from proxy information and filing requirements — namely (i) making the proxy advisor's voting advice available to the subject company at or before the time such advice is disseminated to the proxy advisor's clients and (ii) providing a mechanism by which the proxy advisor's clients can reasonably be expected to become aware of the subject company's written responses to such voting advice.

From a practical perspective, the amendments preserve the status quo and companies may not experience any changes in their interactions with proxy advisors as a result of these amendments, but should nevertheless be aware of the change.[85]

[83] See our July 27, 2020, client alert "SEC Adopts Proxy Rule Amendments Relating to Proxy Voting Advice Businesses."

[84] See our July 14, 2022, client alert "SEC Rescinds Certain 2020 Amendments to Rules Governing Proxy Advisors."

[85] The conditions for proxy voting advice to qualify for an exemption from the proxy solicitation rules did not become effective until December 1, 2021. However, on June 1, 2021, the Division of Corporation Finance of the SEC issued guidance that it would not recommend enforcement action to the SEC based on the 2020 amendments while the SEC considered whether to take further regulatory action regarding the 2020 amendments.

Consider Shareholder Proposal Trends and Developments

The 2022 proxy season held a number of surprises for public companies dealing with shareholder proposals. Below is a brief summary of observations and an overview of recent developments relating to Exchange Act Rule 14a-8.

2022 Proxy Season Summary

An Influx of Prescriptive Proposals, but Less Investor Interest

The number of shareholder proposals submitted to companies in the 2022 proxy season increased from the prior season — 958 in 2022, an increase from the 892 in 2021. The overall number of proposals that went to a vote also increased, from 429 in 2021 to 551 proposals in 2022.

Despite the increased number of proposals submitted and voted on, overall support for shareholder proposals weakened. The SEC also took a more restrictive posture toward no-action requests to exclude shareholder proposals, which may have led to an increase in topics on ballots in which shareholders at large were not interested. In this regard, the staff only granted no-action relief in 41% of cases in 2022, compared to 70% in the prior year.

Highlights of Specific Proposal Topics

Environmental and Social (E&S) Proposals: For the sixth year in a row, E&S proposals outpaced the total number of governance proposals submitted to companies, with 573 E&S proposals submitted compared to 332 governance-focused proposals. Consequently, more E&S proposals (279) than governance proposals (236) ultimately landed on companies' ballots. Thirty-six E&S proposals received majority support in 2022, about the same number as in 2021 (37).

Notably, a large number of environmental proposals (226) were submitted to companies, which addressed a broad range of topics. In contrast to 2021, a relatively large number (90) of environmental proposals ultimately moved to a vote in 2022. Average support for those proposals that appeared on ballots, however, was approximately 31%, less than the approximately 37% average support level seen in 2021.

Shareholders submitted to companies roughly the same number of proposals addressing social issues in 2022 as shareholders did in 2021, with 347 social proposals submitted in the 2022 proxy season (compared to 346 in 2021). More of these proposals moved forward onto companies' ballots in 2022 (189) as compared to 2021 (111). Average support for these social proposals decreased to 26% in 2022 as compared to the 36% average support level seen in 2021. Twenty-one social proposals received majority support in 2022, about the same amount as in 2021 (23).

Continuing a trend seen in 2021, proposals relating to diversity, equity and inclusion (DEI) continued to grow in number. One type of DEI proposal that related to civil rights and racial equity audits received 41 shareholder proposals in 2022 (of which 24 moved forward to a vote) with 44% average support (as compared to 14 proposals in 2021 of which 10 moved forward to a vote with 34% support). Eight of these proposals received majority support in 2022 (while none of this proposal type received majority support in 2021).

Governance Proposals: As compared to the 2021 season, a smaller percentage of the proposals that moved forward to a vote in 2022 concerned governance-related topics, with 236 out of 567 proposals addressing governance topics in 2022 (compared with 249 out of 429 in 2021). Forty governance proposals received majority support in 2022, a decrease from 52 in 2021.

The most popular governance topic in 2022 related to requests to provide for, or make easier, the ability of shareholders to call a special meeting, with 119 proposals submitted, 111 voted on (with 37% average support) and 10 receiving majority support, all up from 37 special meeting proposals submitted in 2021, 31 voted on (with 34% average support) and four receiving majority support.

Proposals calling for an independent chair were the second most common governance topic in 2022, with 39 proposals voted on (compared to 35 in 2021). Average support for independent chair proposals decreased slightly to approximately 29% in 2022 from approximately 31% in 2021, with none of these proposals receiving majority support in 2022 (compared to one that received support in 2021). Generally these proposals fail to achieve majority support absent a larger governance issue at the company.

The third most common governance topic in 2022 related to requests to adopt or amend proxy access rights. The number of proxy access proposals voted on in 2022 decreased to 13 from 29 in 2021, and the average support declined to approximately 32% in 2022 from 34% in 2021.

Executive Compensation Proposals: The number of executive compensation-related proposals submitted in 2022 increased to 53 from 52 in the 2021 proxy season. The number of executive compensation-related proposals that moved forward to a vote also increased — to 36 in 2022 from 25 in 2021 — and the proposals voted on in 2022 had higher average support of approximately 34% (compared with approximately 20% in 2021).

The increase in the number of compensation proposals that moved forward to a vote in 2022 and the higher average support was largely the result of 17 proposals voted on that related to shareholder approval of severance arrangements (with 45% average support).

Four executive compensation proposals received majority support in 2022 (after only one received majority support in 2021). All four proposals that received majority support in 2022 related to shareholder approval of severance arrangements.

Effect of Staff Legal Bulletin No. 14L

In November 2021, the SEC staff issued Staff Legal Bulletin No. 14L (SLB 14L), which had a significant effect on the no-action letter process during the 2022 proxy season. In SLB 14L, the staff took the unprecedented action of rescinding staff guidance published under the previous SEC administration. This ultimately led to the reversal of a number of no-action decisions published in prior years.

While SLB 14L indicated that the staff would revert to using a historical approach to no-action letters, results seemed to indicate that a new approach was in effect. As noted above, the number of no-action letters granted declined dramatically. A number of long-standing staff positions, even those predating the rescinded Staff Legal Bulletins, also were reversed. For example:

Ordinary Business Matters

- **Litigation Strategy**: Historically, the SEC staff has shown deference to arguments that a proposal might affect litigation to which a company is a party, even where a significant policy issue is implicated. Some staff decisions in the 2022 proxy season appeared to deviate from this approach, however, as the staff denied no-action relief for a proposal relating to a third-party civil rights audit where the company argued that the proposal would interfere with its litigation strategy. In the 2021 proxy season, the staff granted relief for a similar proposal where the company was involved in relevant litigation.
- **Human Capital Management**: SLB 14L noted that proposals "squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company." This approach was evident, but often at odds with historical precedent, in the 2022 proxy season. In one case, the staff denied no-action relief for a proposal that asked the company to adopt and disclose a policy requiring that all employees accrue paid sick leave. The staff had permitted exclusion of a similar proposal in the 2021 proxy season.
- **Micromanagement**: SLB 14L outlined a revised and more stringent approach to the micromanagement prong of the ordinary business exclusion. Specifically, the staff explained that its previous approach (under the rescinded Staff Legal Bulletins) may have "been taken to mean that any limit on company or board discretion constitutes micromanagement." The staff stated in SLB 14L that it will take a "measured approach" to micromanagement arguments, focusing on "the level of granularity sought in the proposal and whether and to what extent it inappropriately limits discretion of the board or management." SLB 14L noted that the staff will not concur with the exclusion of proposals addressing climate change that "suggest targets or timelines so long as the proposals afford discretion to management as to how to achieve such goals."

Substantial Implementation

- **Eliminating Supermajority**: The staff appeared to apply new standards to substantial implementation arguments relating to

proposals seeking to eliminate supermajority voting requirements in companies' governing documents. In one example, the staff rejected an argument that a company substantially implemented a proposal requesting it replace greater-than-simple-majority voting requirements in its charter and bylaws with a majority-of-votes-cast standard where the company explained that its governing documents did not contain any supermajority voting provisions. The denial was based on the fact that the company appeared to be subject to certain supermajority voting requirements under applicable state law and that the company's governing documents did not otherwise provide for a lower voting standard.

- **Proxy Access**: In precedent going back to 2016, the staff agreed that adopting a typical "3-3-20-20" proxy access bylaw substantially implemented proposals requesting adoption of proxy access rights for an unlimited number of shareholders holding at least 3% of a company's shares for at least three years. In a number of instances in the 2022 proxy season, however, the staff denied no-action requests, seemingly because the bylaw did not provide for an unlimited number of shareholders to aggregate their holdings

In summary, SLB 14L seemed to open the floodgates for shareholder proponents and as a result, shareholders were presented with more proposals on a wider range of topics with which they often disagreed.

Proposed Amendments to Rule 14a-8

On July 13, 2022, the SEC proposed amendments that would modify the standards for exclusion under the "substantial implementation," "duplication" and "resubmission" bases for exclusion of Rule 14a-8. Although presented as an effort to provide greater certainty and transparency to shareholder proponents and companies, the amendments (if adopted as proposed) likely would increase the number of shareholder proposals received by companies and make it less likely that proposals could be excluded.

Substantial Implementation: Rule 14a-8(i)(10) allows a company to exclude from the company's proxy materials a shareholder proposal that "the company has already substantially implemented." In determining whether a proposal has been substantially implemented, the staff assesses whether a company's particular policies, practices and procedures "compare favorably" with the guidelines of the proposal, whether the company has addressed the proposal's underlying concerns and whether the essential objectives of the proposal have been met. Historically, a proposal could be excluded on the basis of substantial implementation even if a company had not implemented all of the proposal's requested elements.

The proposed amendments would provide that a company may exclude a proposal as substantially implemented "[i]f the company has already implemented the essential elements of the proposal." In particular, the proposing release notes that the proposed amendment would permit a shareholder proposal to be excluded as substantially implemented only if the company has implemented all of the shareholder proposal's essential elements.

Duplication: Rule 14a-8(i)(11) provides that a company may exclude a shareholder proposal from the company's proxy materials if the proposal "substantially duplicates [by sharing the same "principal thrust" or "principal focus"] another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting." The proposed amendments would specify that a proposal "substantially duplicates" another proposal previously submitted for the same shareholder meeting if it "addresses the same subject matter and seeks the same objective by the same means."

Resubmission: Rule 14a-8(i)(12) provides that a company may exclude a shareholder proposal from the company's proxy materials if the proposal "addresses substantially the same subject matter" as a proposal that was included in the company's proxy materials, voted on in the last three years and failed to received support above a certain threshold. The proposed amendments would provide that a proposal qualifies as a resubmission only if it "substantially duplicates" a previous proposal that failed to receive support above a certain threshold, meaning that it "addresses the same subject matter and seeks the same objective by the same means."

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