Matters To Consider for the 2025 Annual Meeting and Reporting Season

Skadden

12 / 11 / 24

Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates

The Americas
Boston
Chicago
Houston
Los Angeles
New York
Palo Alto
São Paulo
Toronto
Washington, D.C.
Wilmington

Europe
Brussels
Frankfurt
London
Munich
Paris

Asia Pacific
Beijing
Hong Kong
Seoul
Shanghai
Singapore
Tokyo

© Skadden, Arps, Slate, Meagher & Flom LLP. All rights reserved.

Companies have important decisions to make as they prepare for the 2025 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.

Checklist of Matters To Consider for the 2025 Annual Meeting and Reporting Season

Disclosure Developments

- **Assess Trends in Cybersecurity Disclosures**
  page 4
- **Review SEC Staff Comments: Areas of Focus**
  page 6
- **Prepare for Compliance With Climate-Related Disclosure Rules**
  page 7
- **Note Changes in Beneficial Ownership Reporting Rules**
  page 9
- **Consider Artificial Intelligence Disclosure**
  page 10
- **Prepare To File Insider Trading Policies**
  page 11
- **Confirm Requirements for Resource Extraction and Conflict Minerals Form SD Disclosures**
  page 12
- **Prepare for EDGAR Filer Access and Account Management Changes**
  page 13

Executive Compensation Considerations

- **Incorporate Lessons Learned From the 2024 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2025 Pay Ratio Disclosures**
  page 14
- **Plan for the Third Year of Pay-Versus-Performance Disclosures**
  page 18
- **Prepare for 2025 Pay Ratio Disclosures**
  page 21
- **Prepare for New Option Grant Practice Disclosures**
  page 22
- **Review Clawback Policies**
  page 23
- **Evaluate Hart-Scott-Rodino Act Implications on Executive Compensation**
  page 27

Annual Meeting and Corporate Governance Trends

- **Revisit Disclosure Controls and Procedures for Related Party-Transactions**
  page 29
- **Examine D&O Questionnaires and Consider Personal Relationships in Director Independence Determinations**
  page 29
- **Assess the Impact of Proxy Advisory Voting Guidelines**
  page 30
- **Review Shareholder Proposal Trends and Developments**
  page 31
- **Revisit Advance Notice Bylaw Provisions**
  page 35
- **Consider Enhancing Voluntary Proxy Disclosures**
  page 35

Disclosure Developments

Assess Trends in Cybersecurity Disclosures

The Securities and Exchange Commission (SEC) adopted final rules in 2023 intended to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance and incident reporting by public companies, including foreign private issuers (FPIs). Specifically, the SEC's amendments require: (i) current reporting of material cybersecurity incidents on a new Item 1.05 of Form 8-K; and (ii) annual reporting on Forms 10-K and 20-F of company processes for identifying, assessing and managing material risks from cybersecurity threats; management's role in assessing and managing the company's material cybersecurity risks; and the board's oversight of cybersecurity risks.

Guidance on Form 8-K Disclosure of Material Cybersecurity Incidents

Item 1.05 of Form 8-K requires disclosure within four business days after a company determines that a "cybersecurity incident" experienced by the company is material. This year, the SEC staff clarified incident reporting requirements as outlined below.

FBI, DOJ and SEC Guidance on Delayed Reporting: The Form 8-K Item 1.05 cybersecurity incident reporting rules provide that companies may delay the required disclosure if such disclosure poses a substantial risk to national security or public safety. In December 2023, the Federal Bureau of Investigation (FBI), the U.S. Department of Justice (DOJ) and the SEC each released guidance on how companies may request this exception and how the agencies will make determinations.

- The FBI issued a policy notice describing the process for requesting a delay in public reporting of a cybersecurity incident under the SEC rule. The notice states that companies must (i) make such requests to the FBI "concurrently" with the company's materiality decision; and (ii) provide the date and time (including time zone) of the company's materiality determination for the FBI to confirm that the request is made "immediately upon determination." To request a delay, companies must contact the FBI through a dedicated email address: cyber_sec_disclosure_delay_referrals@fbi.gov. The FBI also published guidance that outlines the information companies must include in a delay request.
- The DOJ issued guidelines on determinations for delayed public reporting of material cybersecurity incidents clarifying that such determinations hinge on whether the public disclosure of a cybersecurity incident threatens public safety or national security, and not whether the incident itself poses a substantial risk to public safety and national security.
- The SEC staff published four Compliance and Disclosure Interpretations (C&DIs) regarding the national security and public safety exception and related FBI and DOJ guidance, highlighting circumstances where an Item 1.05 Form 8-K is due even if a delay is requested and emphasizing that consultation with a government agency is not conclusive for the company's materiality determination.

Item 1.05 Disclosure for Material Incidents: In May 2024, the Director of the SEC's Division of Corporation Finance issued a statement that clarified, "[a]lthough the text of Item 1.05 does not expressly prohibit voluntary filings, Item 1.05 was added to Form 8-K to require the disclosure of a cybersecurity incident 'that is determined by the registrant to be material' and, in fact, the item is titled 'Material Cybersecurity Incidents.'" Prior to this statement, many companies had issued Item 1.05 disclosure that stated either (i) the cybersecurity incident was not material or (ii) the company had not yet determined whether the incident was material.

The SEC statement discouraged companies from including voluntary disclosure under Item 1.05 and instead encouraged companies to use Item 8.01 to avoid investor confusion. If a company initially discloses a cybersecurity incident under Item 8.01 and later determines that the incident is material, the company should then issue an Item 1.05 Form 8-K within four days of such materiality determination.

Staff Comments on Cybersecurity Risk Management & Governance Disclosures

New Form 10-K "Item 1C. (Cybersecurity)" and Form 20-F "Item 16K. Cybersecurity" require certain new annual cybersecurity-related disclosures. Item 106(b) of Regulation S-K requires a description of the company's processes, if any, for assessing, identifying and managing material risks from cybersecurity threats. Item 106(c) of Regulation S-K requires companies to disclose information related to the board's and management's roles relating to cybersecurity. To date, the SEC staff has issued comments on Item 106 disclosure related to the following:

- **Omitting Item 106 disclosure.** For companies that did not include the new Regulation S-K Item 106 requirement in their Form 10-K or Form 20-F, the SEC staff issued comments reminding companies of the requirement to include the disclosure in their annual reports.
- **Enhancing disclosure of management expertise.** For the Item 106(c)(2)(i) disclosure of the management position(s) responsible for cybersecurity risk management, the SEC staff has requested additional detail on the expertise of such person(s). Such detail may include the number of years spent in prior roles for each person disclosed as responsible for managing cybersecurity risk.
- **Clarifying the role of third parties.** Pursuant to Item 106(b)(1)(ii), companies need to disclose whether they engage assessors, consultants or auditors in the company's management of cybersecurity risk. If third parties are engaged for this purpose, companies should describe the third party's role in assisting the company in identifying and managing cybersecurity risks.
- **Disclosing how cybersecurity risk management fits into a company's overall risk management framework.** Item 106(b)(1)(i) requires companies to specifically disclose whether and how the company's processes, if any, for assessing, identifying and managing material risks from cybersecurity threats are integrated into the registrant's overall risk management system. Companies should address this requirement with specificity, rather than, for example, describing how cybersecurity risk management fits into the company's business strategy more broadly, which the SEC staff may view as insufficient disclosure.
- **Clearly stating management and board areas of responsibility.** Pursuant to Item 106(b)(1), companies should explain the management's and the board's areas of cybersecurity risk management and oversight, and provide sufficient detail for a reasonable investor to understand each group's respective processes for managing and overseeing cybersecurity risk.

Recent Cybersecurity Enforcement Actions

On October 22, 2024, the SEC announced enforcement actions against several technology companies for making materially misleading disclosures regarding cybersecurity risks and intrusions. One company was also charged with disclosure controls violations.

These charges are the result of the SEC's investigation of public companies potentially impacted by the SolarWinds' vulnerability. The enforcement penalties range from $990,000 to $4 million.

The alleged misleading disclosures fall into one of two categories: (i) the disclosures mentioned a cybersecurity incident but omitted material information; or (ii) the disclosures remained largely the same after the cybersecurity incident and did not reflect new and realized cybersecurity risks.

The enforcement actions reinforce that companies should:

- Carefully consider updating disclosures in the wake of cybersecurity incidents, particularly when a company's risk profile changes as a result of an incident.
- Maintain policies and procedures to facilitate prompt escalation of cybersecurity incidents to disclosure decision-makers.
- Understand the SEC's view of materiality and avoid minimizing cybersecurity incidents in disclosures.

Notably, two Republican SEC commissioners issued a strong dissenting statement to these actions. As described below, we anticipate that a new SEC administration will take a different approach to cyber-related enforcement actions.

Takeaways: Companies should revisit existing disclosure controls and procedures (DCP)[1] for SEC filings and assess whether current controls are sufficient to make timely materiality determinations and to capture and report cybersecurity-related information accurately and comprehensively.

[1] 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 Securities Exchange Act of 1934, as amended, Rules 13a-15(e) and 15d-15(e).

- This process may include reviewing and enhancing internal processes and procedures to identify, escalate and disclose cybersecurity incidents to help ensure timely and accurate disclosures.
- This review should also include an evaluation of (i) whether the company's public disclosures are consistent across required filings and voluntary disclosures, (ii) whether statements about the company's cybersecurity risk reflect the facts and circumstances known to the company at the time of disclosure, and (iii) whether any updates to existing disclosure may be required.

In light of the upcoming change in administration, the Republican commissioners' views ae expected to help shape the SEC's priorities in a new administration. As a result, companies should be aware that under the new administration, the SEC may (i) take a less expansive view of materiality in cybersecurity actions and return to a principle-based approach of assessing materiality based on market indicators and investor harm and (ii) focus less on leveraging its controls-based statutory authority to charge public companies for failure to maintain reasonable internal disclosure and accounting controls relating to cyber intrusions.

Review SEC Staff Comments: Areas of Focus

The Disclosure Review Program in the SEC's Division of Corporation Finance has remained active over the past year. During the 12-month period ended June 30, 2024, the volume of SEC staff comment letters and the number of companies receiving comments were consistent with the prior year, but remained elevated compared to historical levels.[2]

Comment Trends

Non-GAAP financial measures and management's discussion and analysis of financial condition and results of operations (MD&A) remained the most frequent areas generating SEC staff comments, and these topics are still the two most significant sources of staff comments by a wide margin. Segment reporting and revenue recognition ranked third and fourth, respectively, once again in the top four most frequent sources for comment.

Goodwill and intangible assets replaced climate-related disclosures as the fifth most frequent topic generating SEC staff comment, with climate-related disclosures dropping out of the staff's top areas of comment, while business combinations became a frequent source of comment, ranking sixth overall.

[2] See Ernst & Young's *SEC Reporting Update* "Highlights of Trends in 2024 SEC Staff Comment Letters" (Sept. 12, 2024).

Recent Areas of Focus

Below is a summary of the SEC staff's 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 C&DIs on non-GAAP financial measures, in certain cases resulting in requests to remove or substantially modify non-GAAP financial measures. For example, SEC staff comments have addressed adjustments to non-GAAP measures that remove or exclude cash operating expenses that the staff views as "normal" or "recurring" in the operation of a company's business, and in the staff's view, presented a misleading measure under C&DI Question 100.01. Additionally, the SEC staff's comments have focused on non-GAAP adjustments related to frequent restructuring and acquisition-related costs, where the staff's comments have asked companies (i) to detail the facts and circumstances supporting an adjustment for what could be a recurring cost and (ii) to explain and quantify the components of these adjustments. Consistent with C&DI Question 102.10(a), SEC staff comments have also objected to companies presenting a full non-GAAP income statement as a form of reconciliation because such presentation gives the non-GAAP information undue prominence.

The SEC staff has also continued to issue comments to determine whether certain key performance indicators (KPIs) are in fact non-GAAP measures and to request that companies present the most directly comparable GAAP financial measure with equal or greater prominence relative to the non-GAAP measure. Although most of these comments address the use of non-GAAP measures in earnings releases and SEC filings, the SEC staff also reviews other materials, including company websites and investor presentations. Accordingly, companies should ensure that any public disclosures of non-GAAP financial measures comply with applicable SEC rules and staff guidance.

MD&A. The SEC staff continues to raise questions about MD&A disclosures, most commonly about results of operations. The SEC staff's comments on results of operations have continued to request that companies explain MD&A disclosures with greater specificity, including identifying and quantifying the impact of each positive or negative factor that had a material effect on results of operations. The SEC staff also continued to highlight the presentation of KPIs and operating metrics, including how they are calculated and period-over-period comparisons. SEC staff comments regularly scrutinized KPIs discussed in earnings releases and investor presentations and questioned how these compare to the information disclosed in MD&A.

SEC staff comments also focused on (i) liquidity and capital resources and (ii) critical accounting estimates. Staff comments on liquidity and capital resources often requested enhanced disclosures of the drivers contributing to changes in cash flows and the trends and uncertainties related to meeting known or reasonably likely future cash requirements. Staff comments regarding critical accounting estimates frequently noted that companies' disclosures were too general, and requested that companies provide a more robust analysis, consistent with the requirements set forth in Item 303(b)(3) of Regulation S-K. The staff often emphasized that critical accounting estimates disclosures should supplement, not duplicate, the disclosures in footnotes to financial statements.

Staff comments on MD&A reporting also addressed known trends or uncertainties, particularly those related to current or emerging trends in the macroeconomic environment such as inflation, interest rates, geopolitical conflicts and supply chain issues. Comments often requested additional disclosures to enhance an investor's understanding of the impact of these trends on the company and the company's response to those trends. As inflation and interest rates moderate and other trends emerge, companies will need to provide transparent, company-specific disclosures about the anticipated impact of such trends to help investors understand how and when companies may be affected by these changing macroeconomic factors. Companies should:

- Regularly reassess and update their MD&A disclosures to include current or emerging trends and uncertainties in the macroeconomic environment.
- Continue to consider CF Disclosure Guidance Topic No. 9 and No. 9A related to COVID-19 and supply chains as well as the SEC staff's Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues issued in May 2022, as much of the guidance in these materials could apply to other macroeconomic trends.

Expected Areas of Focus in 2025

In 2025, we expect SEC staff comments to continue to focus on the reporting areas discussed above. Consistent with public statements from the current director of the SEC's Division of Corporation Finance, the SEC staff may also expand the scope of its comments to address artificial intelligence, cybersecurity and clawbacks.

As noted in the "Assess Trends in Cybersecurity Disclosures — Staff Comments on Cybersecurity Risk Management & Governance Disclosures" section of this checklist, the SEC staff has issued comments on the annual cybersecurity disclosures required by Item 106 of Regulation S-K. While the SEC staff has only issued a few comments on Item 106 cybersecurity disclosures to date, we expect the volume of comments on cybersecurity to expand, with an initial priority on compliance with the Item 106 disclosure requirements.

We also expect that SEC staff comments on clawback disclosures may appear more frequently, including reminders to file a clawback policy and assessments of disclosures when a recovery analysis is triggered, in accordance with the final rules adopted by the SEC in October 2022.

For more information regarding the SEC's focus on artificial intelligence, cybersecurity and clawbacks, see the "Consider Artificial Intelligence Disclosure," "Assess Trends in Cybersecurity Disclosures" and "Review Clawback Policies" sections of this checklist.

In addition, the SEC staff may review and issue comments regarding companies' compliance with the SEC's recently adopted disclosure rules on insider trading policies and procedures and on option grant practices. For additional considerations regarding these disclosure requirements, see the "Prepare to File Insider Trading Policies" and "Prepare for New Option Grant Practice Disclosures" sections of this checklist.

Prepare for Compliance with Climate-Related Disclosure Rules

The regulatory landscape for climate-related disclosures continues to evolve. The future of the SEC's climate disclosure rules adopted in March 2024[3] (SEC Climate Rules) remains uncertain given the pending litigation challenging the rules and the upcoming change in administration. In April 2024, the SEC voluntarily stayed the effectiveness of the SEC Climate Rules pending judicial review. The SEC made clear, however, that its 2010 climate guidance,[4] which provided the basis for the sample comment letter issued in September 2021 by the SEC's Division of Corporation Finance[5] and subsequent comment letters to companies, remains applicable.

In addition, a growing number of jurisdictions in the U.S. and abroad are requiring climate-related disclosures, and for many companies, some form of climate disclosure will become mandatory regardless of the future of the SEC Climate Rules. For example, for many companies that "do business" in California, California's sweeping climate disclosure rules will phase in

[3] See our March 8, 2024, client alert "SEC Adopts New Rules for Climate-Related Disclosures." In April 2024, in response to multiple legal challenges, the SEC voluntarily stayed the effectiveness of the climate disclosure rules pending judicial review.

[4] See Commission Guidance Regarding Disclosure Related to Climate Change, Rel. Nos. 33-9106; 34-61469 (Feb. 2, 2010), 75 Fed. Reg. 6290 (Feb. 8, 2010).

[5] See Sample Letter to Companies Regarding Climate Change Disclosures, SEC Staff Guidance (Sept. 2021).

beginning with fiscal year 2025.[6] While the European Union's disclosure rules under the Corporate Sustainability Reporting Directive (CSRD) initially will apply only to EU-incorporated companies, for fiscal years starting on or after January 1, 2028, non-EU companies must report if they have a significant presence in the EU (defined by minimum EU revenues and asset thresholds).[7]

Preparing for Compliance

In this evolving landscape, companies should stay apprised of the applicability of various climate disclosure rules and proactively consider the necessary steps to comply with current and expected climate-related disclosure rules in the jurisdictions in which they operate. Additionally, maintaining a practice of preparing for compliance with the expected climate rules aligns with broader investor and other stakeholder expectations for robust voluntary climate-related disclosures.

Climate-related disclosures included in SEC filings "filed" with the SEC are subject to potential liability under Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act) and Section 11 of the Securities Act of 1933, as amended (Securities Act) (if included in or incorporated by reference into a Securities Act registration statement). These provisions impose liability on issuers for making false or misleading statements in SEC filings with respect to any material fact relied on by investors. As companies add or expand climate-related disclosures in their SEC filings, they are likely to face increased potential liability from expanded disclosures.

Moreover, as discussed in detail in our client alert "The Informed Board, Summer 2023 – The EU's New ESG Disclosure Rules Could Spark Securities Litigation in the US," climate-related disclosures provided in response to other jurisdictions' regulatory requirements may be subject to the anti-fraud provisions of U.S. securities laws and potential scrutiny by U.S. investors looking for statements that could be the basis for a lawsuit.

Thus, companies should consider taking a proactive and methodical approach to climate-related DCP to minimize exposure to liability based on inaccurate or incomplete disclosures. At the same time, in light of the growing focus on, and demand for, climate-related disclosures and the uncertainty around the SEC Climate Rules, companies should consider an approach that balances risk tolerance, climate disclosure readiness and competition for compliance resources. Considerations for enhancing climate-related DCP include the following:

- **Internal oversight.** Companies should assess whether their current disclosure oversight structure is set up to manage climate-related disclosures, including whether the company's disclosure committee regularly reviews climate-related disclosures and includes the appropriate personnel. Alternatively, a company that has separate disclosure committees for SEC reporting and sustainability disclosures should consider whether there is sufficient coordination and communication, including overlapping members, between the two committees.
- **Materiality considerations.** Disclosures required under existing SEC rules, as well as under the SEC Climate Rules, are based on materiality determinations under the traditional materiality standard — *i.e.*, whether a reasonable investor would likely consider information important when deciding to buy, sell or vote securities. Companies should assess the impact of climate-related risks on their business as a whole and should consider designing a materiality assessment process that can capture and present for consideration all significant and applicable aspects of the company's climate-related risks and strategies for disclosure. Companies should develop and consistently apply criteria for assessing materiality, taking into account quantitative and qualitative factors as well as industry norms, regulatory guidance, and stakeholder expectations. This process should involve input from cross-functional teams, such as legal, finance, sustainability, and operations, to produce a comprehensive view of the company's climate-related risks and opportunities. Companies that are subject to multiple climate disclosure regimes also should be mindful of differing "materiality" standards under other disclosure frameworks — for example, the EU's CSRD incorporates a "double materiality" standard.[8]
- **Subcertification process.** Enhancing or adopting subcertification processes can help ensure that climate-related information is accurately captured and reported. Subcertifications involve designating personnel in the relevant departments certify the accuracy and completeness of the information they provide in order to increase accountability and reduce the risk of errors or omissions.
- **External engagements and assurance.** Engaging external advisers with expertise in compiling climate-related data and preparing related disclosures can provide valuable insights and enhance DCP. A company's team of external advisers may include consultants, legal advisers and third-party attestation providers (which, under the SEC Climate Rules, may be the company's independent auditor for financial reporting purposes). A company that is required to retain an attestation provider under the CSRD or other regulatory mandates may

[6] See our October 28, 2024, client alert "State of Play: California Amends Climate Disclosure Rules."

[7] See our October 9, 2023, client alert "Q&A: The EU Corporate Sustainability Reporting Directive – To Whom Does It Apply and What Should EU and Non-EU Companies Consider?"

[8] Under the CSRD, companies must assess (i) how their business is impacted by sustainability-related factors (financial materiality) and (ii) how their activities impact society and the environment through emissions and employment creation (impact materiality).

want to consider whether that provider qualifies as independent under the SEC Climate Rules. In addition, companies should confer with their auditors when implementing controls to track climate-related impacts on the financial statements.

- **Board and committee oversight.** Thoughtful assignment of board and committee oversight responsibilities is necessary for tracking, assessing and reporting climate risk. While in some cases environmental, social and governance (ESG) oversight may fall within the purview of the board more generally, boards may consider delegating responsibility for more detailed review of climate-related disclosures to a board committee.
- **Coordinated public disclosures.** Stand-alone ESG or sustainability reports and other climate-related disclosures outside of SEC filings, including in response to state or other countries' disclosure requirements, should be consistent with SEC filings to avoid discrepancies. While companies may include certain disclosures in voluntary reporting that are not included in SEC filings, companies should make clear (i) why they are presenting such voluntary disclosures and (ii) that such voluntary disclosures are not material. Companies may choose to include such voluntary disclosures in their SEC filings with an explanation of why the information is provided (*e.g.*, if the information is not material but provides helpful context).

Consistency is essential to maintain stakeholder trust and avoid potential regulatory scrutiny. To help ensure consistent and accurate public disclosures across platforms for both required and voluntary disclosures, companies should consider:

- Regularly reviewing and reconciling public statements made in SEC filings, in other regulatory filings and through other media to confirm all climate-related information is accurate and aligned across disclosures.
- Analyzing appropriate differences between nonmaterial climate-related statements for noninvestor stakeholder audiences and reporting material climate-related risks and impacts for investors.
- Maintaining a calendar of climate-related disclosure activities, disclosures and deadlines, which can help build a cadence of internal processes and facilitate consistent disclosures over time.
- Assembling and regularly communicating with cross-functional teams and external advisers to coordinate a comprehensive and harmonized approach.

Note Changes in Beneficial Ownership Reporting Rules

Overview

On October 10, 2023, the SEC adopted amendments to its beneficial ownership rules. Pursuant to the amendments, Schedules 13D and 13G are now required to be filed on a more accelerated basis. The new beneficial ownership rules became effective beginning on February 5, 2024, and companies had until September 30, 2024, to begin complying with the new Schedule 13G accelerated filing deadlines. Under the old rules, except in certain situations, Schedule 13G filings were required to be amended within 45 days after the end of the calendar year for any changes to the previous disclosure. The amended rules require that all Schedule 13G filings be amended within 45 days after the end of the calendar quarter in which any material change occurred.

The first Schedule 13G amendments under the new rules were required to be filed by November 14, 2024. Filers should continue to assess whether any material change in the information previously reported has occurred during each quarter. The SEC declined to define what constitutes a material change for these purposes and instead pointed to the general concept of materiality (as defined in Exchange Act Rule 12b-2). The SEC signaled that any acquisitions or dispositions of 1% or more of the outstanding class of securities should be deemed material for Schedule 13G amendment purposes, based on the 1% threshold prescribed under Rule 13d-2(a) for Schedule 13D amendment purposes.

For initial filers, the amended rules require the filing of an initial Schedule 13G within 45 days after the end of the quarter in which a qualified institutional investor or exempt investor crosses the 5% threshold at quarter-end, or within five business days of crossing the threshold for passive investors.

Recent SEC Enforcement Actions

In September 2024, the SEC announced another enforcement sweep involving Section 13/16 beneficial ownership reporting. The SEC previously took broad-reaching actions in this area, including in 2014, 2015 and 2023.

As part of the 2024 sweep, the SEC settled charges against 23 entities and individuals for failures to timely report information about their holdings and transactions, including in multiple Section 16(a) reports (primarily Forms 4 and 5) and/or Schedule 13D filings required under the Exchange Act. Two public companies were charged for contributing to filing failures by their officers and directors and failing to report the companies'

insiders' filing delinquencies in their proxy statements. Although individual insiders are ultimately responsible for complying with the Section 16(a) disclosure requirements, many companies voluntarily take on the obligation to prepare and file Section 16 reports on behalf of their officers and directors. In its orders, the SEC noted that "issuers who voluntarily accept certain responsibilities and then act negligently in the performance of those tasks may be liable as a cause of Section 16(a) violations by insiders."

One entity was also charged for failing to timely file Form 13F reports, which are required to be filed by any institutional investment manager that exercises investment discretion over certain publicly traded securities with a fair market value of at least $100 million.

While beneficial ownership reporting investigations often result in charges against individuals and smaller companies that may not have robust disclosure controls, among the charged entities were a large technology company and leading global investment bank. The SEC's settlement order with the investment bank noted, among other things, that the bank and some of its affiliates failed to timely file multiple required Section 16 reports, with the SEC documenting at least 28 instances of violations. The order cited failures of the bank's systems and controls, misapplication of policy exceptions to the bank's restricted lists, failures to timely identify when the bank became a 10% beneficial owner (which would trigger a Form 3 filing and future Form 4 filing obligations), and internal delays in gathering or verifying information for filings.

Without admitting or denying the findings, the entities and individuals agreed to cease and desist from violations of the respective charged provisions and to pay civil penalties ranging from $10,000-$200,000 for the individuals and $40,000-$750,000 for the entities. The two public companies charged with contributing to insiders' reporting failures and not disclosing such delinquencies agreed to pay a civil penalty of $200,000 each.

Considerations

The SEC's announcement of the settled charges described above serves as a timely reminder for companies to ensure adequate systems and controls for beneficial ownership reporting obligations, especially given the new Schedule 13G accelerated filing deadlines.

- Ensuring compliance with obligations under Sections 13 and 16 is particularly important for companies that have undertaken commitments, whether formal or informal, to assist their insiders with required filings.
- Companies should also confirm that the relevant employees and directors understand their reporting obligations under Sections 13 and 16 (including Form 13F filings by certain institutional investment managers and Form 13H filings for certain large traders).
- Finally, companies should carefully review the disclosures required by Item 405 of Regulation S-K in their annual reports on Form 10-K or proxy statements to help ensure accurate descriptions of any delinquent Section 16 filings or failures to file.

Recent statements from the SEC staff indicate that Section 13 and 16 matters will continue to be a priority in 2025. We expect that the staff will (i) use new technology to identify late Schedule 13D and Schedule 13G filings and (ii) comment more frequently on Schedule 13D filings where material deficiencies have been identified.

Consider Artificial Intelligence Disclosure

Evaluating Trends

The development, use and potential impact of artificial intelligence (AI) is a key focus for market participants, including investors and the SEC.[9] In an analysis of annual reports on Form 10-K filed by S&P 500 companies for the fiscal year ended 2023, over 40% of Forms 10-K included disclosures about AI.[10] Also, more than 40% of S&P 500 companies cited "AI" during earnings calls in the second quarter of 2024.[11] Furthermore, 46% of Fortune 100 companies included AI-related risk disclosures in their annual reports on Form 10-K, with such disclosures falling broadly into one of the following categories: (1) cybersecurity risk; (2) regulatory risk; (3) ethical and reputational risk; (4) operational risk; and (5) competition risk.[12]

In light of these trends, companies should evaluate the role of AI in their business and consider incorporating new or updated AI disclosures in Exchange Act reports, if applicable.

SEC Guidance

In June 2024, the SEC's Division of Corporation Finance announced that AI was a disclosure priority. The division will consider (i) how companies are defining "artificial intelligence" and how the technology could improve their business; (ii) whether companies are providing tailored, rather than boilerplate, disclosures discussing the materiality to the companies' business, material risks, and impact on the business and financial results; (iii) whether a company's business involves AI or if companies are merely using "buzz" words; and (iv) whether companies have a reasonable basis for their claims when discussing AI prospects.

[9] See PwC's *Global Investor Survey 2024* (Dec. 4, 2024).

[10] See Bloomberg Law, "AI Disclosures to SEC Jump as Agency Warns of Misleading Claims" (Feb. 8, 2024).

[11] See FactSet, "More Than 40% of S&P 500 Companies Cited 'AI' on Earnings Calls for Q2" (Sept. 13, 2024).

[12] See Alston Bird's *Securities Litigation Advisory*, "Navigating AI-Related Disclosure Challenges: Securities Filing, SEC Enforcement, and Shareholder Litigation Trends" (July 26, 2024).

More recently, in September 2024, SEC Chair Gensler stated that companies must ensure that their statements about AI capabilities and risks have a reasonable basis and are specific to the company, rather than relying on vague or generic language.

Disclosure Considerations

Currently, there are no specific SEC disclosure requirements related to AI. However, as with other factors that impact a company's business, disclosures related to AI may be required when responding to item requirements in periodic reports. For instance, companies may be required to address AI when describing the company's business, the impact of regulations on the company's business and the risk factors associated with an investment in the company.

- Given the SEC's focus on AI disclosures, companies that determine to include AI disclosures in their reports should confirm that those disclosures accurately detail the company's AI capabilities and the impact or potential impact of AI on the company's business.
- If AI development at a company is in early stages and the potential impact of AI is uncertain, the company should clearly describe the process and steps that may be required to realize the expected impact.
- Companies should also consider describing (i) whether they are developing their own AI capabilities or relying on third-party service providers and (ii) whether there are material risks to the company from its use of AI or from the development of AI by competitors or others in the market.

Prepare To File Insider Trading Policies

In December 2022, the SEC adopted several amendments to Exchange Act Rule 10b5-1 and new disclosure requirements relating to Rule 10b5-1 trading plans, certain equity awards and gifts of securities.[13] Among other things, the rules require companies to file a copy of their insider trading policies and procedures as an exhibit to their annual reports on Form 10-K.[14] For calendar-year companies, this exhibit filing requirement applies to the Form 10-K for the fiscal year ending December 31, 2024.[15] As the deadline approaches, companies should consider if updates to their insider trading policies are necessary for compliance with the amendments. Below are primary insider trading policy provisions for companies to revisit before filing their policies as exhibits.

Rule 10b5-1 Plans

To the extent companies permit the use of Rule 10b5-1 plans by directors, executive officers or other employees, their insider trading policies should be updated to ensure such plans comply with the requirements of Rule 10b5-1, as amended, including:

- Minimum cooling-off periods.
- Director and officer representations regarding the adoption and operation of a Rule 10b5-1 plan.
- The expanded "good faith" requirement.
- Prohibitions against multiple, overlapping plans.
- Limitations on single-trade arrangements.

Companies also should consider requiring preclearance for all Rule 10b5-1 plan adoptions and modifications to help ensure that proposed plans comply with Rule 10b5-1. Although Rule 10b5-1 does not restrict the early termination of a plan, such a termination could call into question whether the plan was adopted and operated in good faith, which could impact the availability of the Rule 10b5-1 affirmative defense for transactions that occurred under the terminated plan. Companies should therefore consider requiring advance notice to their legal departments prior to terminating a Rule 10b5-1 plan.

Blackout Periods

Because the announcement of a company's quarterly financial results almost always has the potential to materially impact the market for the company's securities, companies should consider implementing a quarterly blackout period during which persons subject to the blackout may not trade in the company's securities. In setting a blackout period, companies must consider both the appropriate time frame and scope of individuals to include.

The blackout period should begin when the company's quarterly results become both sufficiently certain and visible internally. Based on insider trading policies filed to date by companies in the S&P 500 index, companies commonly start their quarterly blackout periods on or between the first and 15th day of the last month of the quarter, and commonly open the trading window after the first or second trading day following release of the company's earnings.

[13] See our December 2022 client alert "SEC Amends Rules for Rule 10b5-1 Trading Plans and Adds New Disclosure Requirements."

[14] FPIs are required to file a copy of their insider trading policies and procedures as an exhibit to their annual reports on Form 20-F, beginning with the annual report covering the first full fiscal year beginning on or after April 1, 2023.

[15] The exhibit filing requirement applies to annual reports covering fiscal years that began on or after April 1, 2023, except for smaller reporting companies (SRCs). For SRCs, the exhibit filing requirement applies to annual reports covering fiscal years that began on or after October 1, 2023.

Blackout periods typically apply to (i) directors, (ii) officers subject to Section 16 of the Exchange Act and (iii) designated employees who frequently have access to material nonpublic information about the company. However, applying quarterly blackout periods to all employees may be appropriate — this is common where there is broad access internally to financial information or the company has a small number of employees.

Shadow Trading

In April 2024, a jury in federal court found a former executive civilly liable for insider trading. In the first-of-its kind case, the SEC argued that the executive engaged in "shadow trading." More specifically, the SEC argued that the executive used material nonpublic information about the not-yet-public acquisition of his employer to trade in securities of another company with which he had no relationship, on the assumption that the acquisition of his employer would increase the stock price of the other company. In September 2024, a federal court upheld the jury's verdict. (Some members of the legal community anticipate that the former executive will appeal the case.)

In light of this shadow trading case, companies should consider addressing in their insider trading policies trading in other companies' securities on the basis of material nonpublic information obtained in the course of an individual's position with the company. In doing so, companies should consider whether such a prohibition should apply to all other companies or a narrower set, such as the company's business partners and competitors.

Treatment of Gifts

In connection with amending Rule 10b5-1, the SEC cited concerns with potentially problematic practices involving gifts of securities, such as making stock gifts while in possession of material nonpublic information or backdating stock gifts to maximize the associated tax benefits. The SEC noted that a scenario in which an insider gifts stock while aware of material nonpublic information and the recipient sells the gifted securities while the information remains nonpublic and material is economically equivalent to a scenario in which the insider trades on the basis of material nonpublic information and gifts the trading proceeds to the recipient.

Accordingly, companies should consider including specific parameters on gifts in their insider trading policies. For example, companies can require advance clearance for gifts by directors, executive officers and certain employees who are subject to quarterly blackout periods, since those individuals are generally more likely to be in possession of material nonpublic information. As a more conservative option, a company can treat gifts the same way it treats ordinary open market purchases and sales, which would prohibit gifts of securities by anyone subject to the policy while subject to a blackout period or in possession of material nonpublic information.

Confirm Requirements for Resource Extraction and Conflict Minerals Form SD Disclosures

Companies should continue to confirm the applicability of the requirements for resource extraction and conflict minerals reporting on Form SD and, if applicable, prepare to provide the requisite disclosures. Key considerations regarding the resource extraction and conflict minerals requirements on Form SD are summarized below.

Resource Extraction Form SD Disclosures

As discussed in more detail in our August 27, 2024, client alert "New Resource Extraction Payment Disclosures Due September 26, 2024," in December 2020, the SEC adopted final rules requiring "resource extraction issuers," — which includes any company engaged in the commercial development of oil, natural gas or minerals — to annually report certain payments made to foreign governments or the U.S. federal government on Form SD. These requirements had a two-year transition period, with initial Form SD filings required to be filed with the SEC for the first time in 2024.

The next Form SD filing for resource extraction issuers with a December 31 fiscal year-end is required to be filed with the SEC for fiscal year ending December 31, 2024, by September 27, 2025.[16] A resource extraction issuer with a noncalendar fiscal year-end is required to file its next Form SD with the SEC no later than 270 days following the end of the issuer's most recently completed fiscal year.

Conflict Minerals Form SD Disclosures

The next Form SD filing under the conflict minerals disclosure rules is required to be filed with the SEC no later than May 31, 2025.

The conflict minerals disclosure rules and related guidance have remained at a practical standstill for the past few years following legal challenges to the rules and a remand to the SEC for further action. As a result, there have been no notable regulatory updates since the April 2017 no-action relief statement by the SEC's Division of Corporation Finance. In that statement, the division

[16] Because September 27, 2025, falls on a Saturday, the deadline is the next business day (*i.e.*, Monday, September 29, 2025).

indicated it would not recommend enforcement action against companies for not complying with Item 1.01(c) of Form SD — the provision requiring companies to conduct due diligence to determine the source and custody of conflict minerals in their supply chains and to prepare a "conflict minerals report" describing their efforts and findings.[17]

Companies are still required to comply with the requirements of Items 1.01(a) and (b) of Form SD. This means companies that determine conflict minerals are necessary to the functionality or production of their products must make a good faith effort to determine the country of origin of those minerals and to briefly describe their efforts and findings in a Form SD filed with the SEC and made available on the company's website.[18]

Prepare for EDGAR Filer Access and Account Management Changes

On September 27, 2024, the SEC adopted rule and form amendments to improve the Electronic Data Gathering, Analysis and Retrieval (EDGAR) system's filer access and account management. The new system, called EDGAR Next, will impact all public companies, Section 16 officers and directors, any other person who needs to make SEC filings (collectively, "Filers") and their filing agents. All Filers need to take steps to confirm their existing EDGAR filing and account information in order to enroll when the process starts in March 2025.

Unlike the current system, where anyone with the CIK and CCC EDGAR codes of a Filer can make SEC filings on behalf of the Filer without further verification, only people who are specifically designated in the new account system as of September 2025 will be allowed to make SEC filings in EDGAR Next. Therefore, each Filer must set up an account and designate who can make filings on their behalf. EDGAR Next requires all individuals responsible for making SEC filings or managing related accounts on behalf of Filers to obtain account credentials from Login.gov and complete a two-factor authentication to access EDGAR accounts and make filings. The two-factor authentication requires (i) a password and (ii) verification on the phone or an app.

Filers will need to authorize at least two individuals as account administrators to manage the Filer's EDGAR account (at least one account administrator for individuals and single-member companies). The account administrator is responsible for adding other administrators (up to 20) and removing other administrators. EDGAR Next additionally requires annual confirmation by an account administrator to ensure the accuracy of certain account-related information. The account administrator may delegate authority to make SEC filings on behalf of the Filer to another person or entity.

On March 24, 2025, the EDGAR Next system will go live, and existing Filers can start transitioning to the new system. Compliance with the amended Form ID is required to obtain new Filer credentials. On September 15, 2025, compliance with EDGAR Next is required.

While the deadline for existing Filers to enroll is December 19, 2025, such Filers will not be able to make any SEC filings until they enroll. After this date, Filers will be required to submit an amended Form ID in order to request access to their existing accounts. In addition, Filers not in compliance will not be able to file with EDGAR legacy codes. However, during the transition period from March 24 to September 15, 2025, Filers will be allowed to use either their traditional EDGAR or EDGAR Next accounts.

Existing Filers should confirm their EDGAR filing codes before March 24, 2025, to streamline the onboarding process. Filers should decide who or which account administrator will be responsible for managing accounts, making SEC filings and providing annual confirmations on behalf of the Filer. Individuals who will be responsible for managing accounts and making SEC filings on behalf of a Filer should obtain Login.gov credentials before March 24, 2025.

[17] See our April 11, 2017, client alert "SEC Staff Provides Relief From Conflict Minerals Rule."

[18] For additional information concerning the conflict minerals disclosure rules, see our September 5, 2012, client alert "SEC Adopts Conflict Minerals Rules"; June 3, 2013, client alert "SEC Staff Issues Conflict Minerals & Resource Extraction Payments Disclosure Guidance"; April 30, 2014, client alert "SEC Staff Issues Statement on Conflict Minerals Ruling"; and May 2, 2024, client alert "Conflict Minerals Disclosures Due May 31, 2024."

Executive Compensation Considerations

Incorporate Lessons Learned From the 2024 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2025 Pay Ratio Disclosures

Companies should consider their recent annual say-on-pay votes and best practices for disclosure when designing their 2025 compensation programs and communicating about those programs to shareholders. Companies should also review the latest say-on-pay trends, including overall 2024 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 2024 Say-on-Pay Votes

Below is a summary of the results of 2024 say-on-pay votes from Semler Brossy's annual survey.[19] Overall, say-on-pay approval results at Russell 3000 companies surveyed in 2024 were generally more favorable than those in 2023:

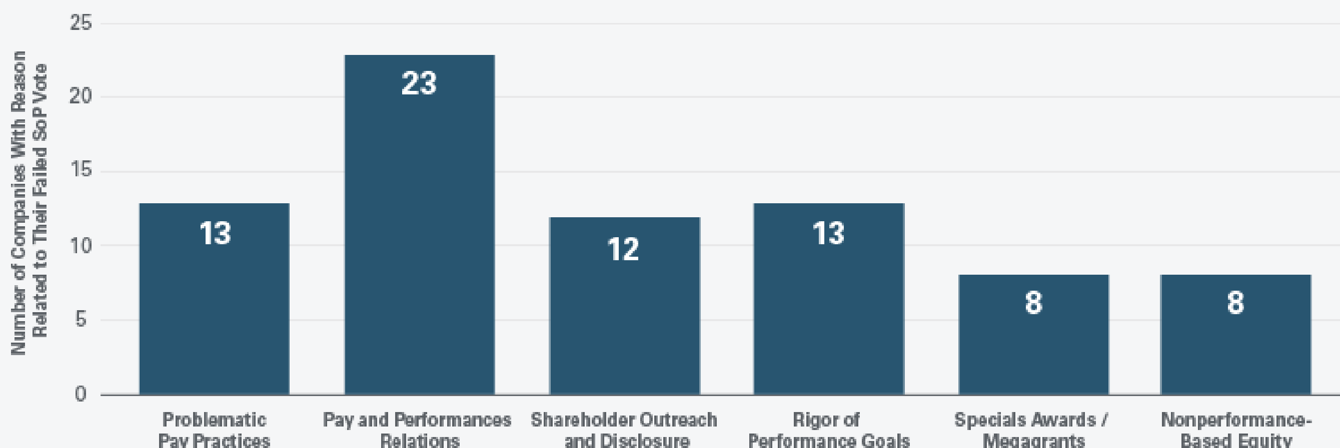
- Approximately 98.8% and 97.9% of Russell 3000 companies in 2024 and 2023, respectively, received at least majority support on their say-on-pay votes, with approximately 94% receiving above 70% support in 2024 and 93% receiving above 70% support in 2023. This demonstrates slightly increased say-on-pay support in 2024 compared with 2023.
- To date in 2024, approximately 88.9% of Russell 3000 companies and 92.3% of S&P 500 companies have received "For" recommendations on their say-on-pay voting items by ISS, a slight increase from the 87.2% and 90.4% "For" recommendations averages in 2023.
- Russell 3000 companies received an average say-on-pay vote result of 91% approval in 2024, which is slightly higher than the average vote result of 90% approval in 2023.
  - The average say-on-pay vote result exceeded 91% approval in 2024 across multiple industry sectors, including energy, utilities, consumer discretionary, materials, financials and consumer staples. 74% of Russell 3000 companies received more than 90% support, which is slightly higher than the 71% of companies receiving greater than 90% support at this time in 2023.
  - The communication services sector featured the lowest level of average support (compared with other industry sectors) at 89.2%.
- As of September 2024, approximately 1.2% of say-on-pay votes in 2024 for Russell 3000 companies resulted in failure to receive approval, which is below the 2.1% rejection rate for 2023.

Factors Driving Say-on-Pay Failure

Overall, the most common factors shareholders cited when voting against say-on-pay proposals were pay and performance relation, problematic pay practices, rigor of performance goals, shareholder outreach and disclosure issues, nonperformance-based equity and special awards, as summarized in the chart below.[20]

[19] See Semler Brossy's report "2024 Say on Pay & Proxy Results" (Sept. 26, 2024). Unless otherwise noted, Semler Brossy's report is the source of pay ratio, say-on-pay and equity plan proposal statistics in this checklist.

[20] *Id.*



Consistent with 2023 results, pay and performance alignment was among the leading causes of say-on-pay failure for 2024. Notably, although shareholder discontent with problematic pay practices significantly decreased from 21 instances in 2023 to 13 instances in 2024, the issue remained one of the most cited reasons for say-on-pay failure in 2024. Also, the tally shows that rigor of performance goals and shareholder outreach and disclosure issues have slightly outpaced special awards and nonperformance-based equity as leading causes of say-on-pay rejections.

ISS Guidance

When evaluating pay practices, proxy advisory firms tend to focus on whether a company's practices are contrary to a performance-based pay philosophy. In December of each year, ISS publishes FAQs to help shareholders and companies understand changes to ISS compensation-related methodologies. In December 2023, ISS published its most recent general U.S. Compensation Policies FAQ.[21] As of the date of this checklist, ISS has not yet released its 2025 guidelines; the advisory firm is expected to release a full set of updated compensation FAQs in mid-December 2024, which will provide additional guidance for 2025. In October 2024, ISS published an interim United States Compensation Policies FAQ,[22] which included the following key updates:

- ISS indicated that effective for meetings occurring on and after February 1, 2025, ISS will not display a realizable pay chart for companies that have experienced multiple (two or more) chief executive officer (CEO) changes within the applicable three-year window (and otherwise, realizable pay will be displayed as before).
- ISS also indicated that for a company's clawback policy to be considered "robust," the policy must extend beyond the minimum requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or Dodd-Frank) and explicitly cover all time-vesting awards. ISS further clarified that a clawback policy that adheres to the minimum requirements of Dodd-Frank will not be considered robust because those requirements generally do not cover all time-vesting awards.[23]

Performance-Based Versus Time-Based Equity Awards

On November 18, 2024, ISS opened a public comment period on the proposed ISS benchmark policy changes for 2025.[24] One of the proposed policy changes relates to the relative mix between performance- and time-based equity awards, as summarized below.

[21] See ISS' FAQ "United States Compensation Policies" (Dec. 14, 2023).

[22] See ISS' FAQ "United States Compensation Policies" (Oct. 11, 2024).

[23] For more information on clawback policy trends, see the "Clawback Policies" section of this checklist below.

[24] See ISS' "Proposed ISS Benchmark Policy Changes for 2025" (Nov. 18, 2024).

Currently, ISS generally views a predominance of time-based (as opposed to performance-based) equity awards to be a significant concern at a company that has pay-for-performance misalignment. However, based on the 2024 Global Benchmark Policy Survey,[25] growing feedback from investors suggests a shift in perspective, largely due to concerns with poorly designed and disclosed performance-based equity programs that have nonrigorous performance measures. As a result, some investors are expressing a preference for time-based equity awards with extended vesting periods.

The ISS survey revealed that while 43% of investors supported maintaining ISS's current view on time-based awards, 70% of noninvestors preferred a change in approach so that time-based awards with extended vesting periods would be viewed positively, particularly if the vesting periods are longer than four years. Both investors and noninvestors displayed strong support (66% and 58%, respectively) for a time-based vesting period of "at least five years."

ISS is considering updating its policy for 2026 (or later). Effective for 2025 (for meetings on or after February 1, 2025), ISS stated that it intends to adapt the current framework by placing greater emphasis on the design and disclosure of performance-based equity awards, which may drive adverse say-on-pay recommendations for companies with pay-for-performance misalignments.

Glass Lewis Guidance

Glass Lewis published its "2025 Benchmark Policy Guidelines for the United States" in November 2024, which included the following compensation updates in effect for the 2025 proxy season:[26]

- Glass Lewis indicated that to aid in the consideration of whether a change-in-control arrangement is double- or single-trigger, companies that allow committee discretion over the treatment of unvested awards should provide a clear rationale for the committee's final decision about how such awards should be treated in the event of a change in control.

Glass Lewis also clarified the following in its 2025 policy guidelines:

- **Say-on-Pay Voting Recommendations:** Glass Lewis clarified that it approaches its analysis of executive compensation programs on a case-by-case basis. Glass Lewis reviews factors such as quantitative analyses, structural features, the presence of effective best-practice policies, disclosure quality and trajectory-related factors. With the exception of particularly egregious pay decisions and practices, no single factor would typically lead to an unfavorable recommendation without a review of the company's rationale and its ability to align executive pay with performance and the shareholder experience.
  - Glass Lewis indicated that its evaluation of whether compensation is "egregious or excessive" for purposes of its say-on-pay voting recommendations includes an assessment of perquisites alongside cash bonuses, equity payments and severance payments.
  - Glass Lewis further indicated that in addition to the existing factors that may cause Glass Lewis to recommend voting against a say-on-pay proposal, the advisory firm will also view "adjustments to performance results that lead to problematic pay outcomes" negatively.
  - Glass Lewis' evaluation for its "Good, Fair, Poor" rating scale will consider the rationale behind each compensation element in addition to the thoroughness of the discussion of all elements of compensation.
  - Companies are expected to provide sufficient information in their proxy statements to enable shareholders to vote in an informed manner. Glass Lewis acknowledges that although regulatory rules, *e.g.*, SRC disclosure standards, may permit the omission of key executive compensation information, companies should still provide sufficient information.
- **Company Responsiveness to Say on Pay:** Glass Lewis clarified that a company's proxy statement should discuss the compensation committee's response to low say-on-pay support.
- **Long-Term Incentives:** Glass Lewis elaborated on its generally negative view of cases where performance-based awards are significantly rolled back or eliminated from a company's long-term incentive plan, stating that such changes will be assessed based on the impact of such change on the alignment of executive pay and shareholder experience. Companies that fail the assessment may receive an unfavorable recommendation if the reduction in rigor and accountability in the company's pay program is not offset by meaningful revisions (*e.g.*, to pay quantum and vesting periods).
  - Glass Lewis added "additional post-vesting holding periods to encourage long-term executive share ownership" to its list of elements that are common to most well-structured long-term incentive plans.
- **One-Time Awards:** Glass Lewis clarified that it reviews grants of supplemental awards on a case-by-case, company-by-company basis.

[25] See ISS' "2024 ISS Global Benchmark Policy Survey" (Oct. 10, 2024).

[26] See Glass Lewis' "2025 Benchmark Policy Guidelines – United States" (Nov. 14, 2024).

- **CEO Pay Ratio:** Even though the CEO pay ratio is not a determinative factor in Glass Lewis voting recommendations, Glass Lewis noted that the underlying data may help shareholders evaluate the rationale for certain executive pay decisions, such as increases in fixed pay levels.

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.

- 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 the link between such increase and specific individual and company performance.

In the year following a say-on-pay vote, proxy advisory firms conduct a thorough review of companies where say-on-pay approval votes fell below a designated threshold: 70% for ISS and 80% for Glass Lewis. ISS' FAQ explains that this review involves investigating the following:

- 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.
- Whether the proposal's support level was less than 50%.

Taking actions to address to these factors can result in effective stakeholder engagement efforts and robust disclosures.

Looking ahead to 2025, 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 2024 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 2024.** Carefully consider how shareholders and proxy advisory firms may 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, document and provide fulsome disclosure of the changes the company will make to its compensation policies** in response to shareholder feedback.
- **Disclose specific shareholder engagement efforts and results in the 2025 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 detailed 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 and how that decision was reached, including factors considered and the process followed.

Say-on-Golden-Parachute Proposal Results

Say-on-golden-parachute votes historically have received lower support than annual say-on-pay votes. In 2024, average support for golden parachute proposals decreased slightly to 79% from 81% in 2023.[27] ISS notes that changes in the

[27] See ISS' "Proxy Season Review – U.S. Executive Compensation" (Sept. 11, 2024).

say-on-golden-parachute failure rate tend to follow trends in the median golden parachute value. In 2024, the median CEO golden parachute compensation increased by 35%.

The failure rate for say-on-golden-parachute proposals reached an all-time high in 2024 at 17%, up from 12% in 2023.

Equity Plan Proposal Results

Average support for equity plan proposals increased in 2024:

- 0.5% of equity plan proposals at Russell 3000 companies received less than a majority vote as of September 2024, compared to more than 1% in previous years (1.4% in 2023).[28]
- Average support for 2024 equity plan proposals as of September 2024 was 87.8%, greater than the 86.7% average support for equity plan proposals in September 2023.[29]

Most companies garner strong support from shareholders for equity plan proposals, regardless of the ISS recommendation:

- As of September 2024, Russell 3000 companies receiving an "Against" recommendation for equity plan proposals still received 75% support for equity plan proposals.[30]
- As of September 2024, the ISS "Against" recommendation rate for equity plan proposals was 29.5% (up from 27.9% in 2023).

ISS Equity Plan Scorecard

- For meetings on or after February 1, 2024, ISS adjusted certain factor scores under the Equity Plan Scorecard (EPSC) for S&P 500, Russell 3000 and Non-Russell 3000 companies and for special cases for the Russell 3000/S&P 500 models (*i.e.*, recent IPOs, spinoffs and bankruptcy emergent companies that do not disclose at least three years of grant data), which include:[31]
  - A decrease in the weighting of the company's shareholder transfer value relative to peers, based on new shares requested plus shares remaining available plus outstanding grants and awards, for S&P 500 and Russell 3000 models.
  - A decrease in the weighting of the grant practices pillar for the S&P 500, Russell 3000 and Non-Russell 3000 models.
  - An increase in the weighting of the plan features pillar for the S&P 500, Russell 3000 and Non-Russell 3000 models.

There are no factor score adjustments for the special cases for the Non-Russell 3000 model. Further, there are no factor definition changes nor threshold passing score changes for any model.

[28] See Semler Brossy's report "2024 Say on Pay & Proxy Results" (Sept. 26, 2024).

[29] See *id.*

[30] See *id.*

[31] See ISS' FAQ "United States Equity Compensation Plans" (Dec. 11, 2023).

Other Proxy Advisory Firm Takeaways

Each year, companies should consider whether to update the compensation benchmarking peers included in ISS' database. ISS uses these company-selected peers when it determines the peer group it will use to evaluate a company's compensation programs. This year, ISS accepted these updates from November 11, 2024, to November 22, 2024.[32]

Plan for the Third Year of Pay-Versus-Performance Disclosures

In August 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. Companies were required to incorporate this information into proxy or information statements that include executive compensation disclosure for fiscal years ending on or after December 16, 2022. Calendar-year companies included this disclosure for the first time in their proxy statements filed in 2023. Companies should now incorporate lessons learned during the 2024 proxy season to prepare for the third year of pay-versus-performance (PvP) disclosure.

Overview

Item 402(v) of Regulation S-K contains the PvP disclosure requirements, which consist of three main components: (i) a PvP table that includes metrics from the previous five fiscal years such as CEO and NEO "compensation actually paid" (CAP), cumulative total shareholder return (TSR) for the company and its peer groups, financial performance measures and the company's net income; (ii) a tabular list of financial measures that the company selected to link CAP to the performance metrics; and (iii) a description of the relationship between CAP and the company's performance metrics.

Specifically, the PvP table requires disclosure of:

- The total compensation of the CEO and the average total compensation of the other NEOs, using the information required to be reported in a Summary Compensation Table.
- The compensation "actually paid" to the CEO and the average total compensation "actually paid" to the other NEOs, calculated in accordance with Item 402(v), along with footnote disclosure of any amounts deducted and added to total compensation of the NEOs to determine the amount of compensation "actually paid."
- The TSR of both the company and its peer group.
- The company's net income (under GAAP).

[32] See ISS' "Company Peer Group Feedback" (2024).

- A financial performance measure selected by the company that in the company's assessment represents the single most important financial measure used for the most recently completed fiscal year to link the company's performance to CAP to the company's NEOs.

Listing Important Financial Measures: Companies also must provide an unranked tabular list of at least three and up to seven financial performance measures (tabular list) that in each company's assessment represent the most important financial performance measures the company used for the most recently completed fiscal year to link CAP for the company's CEO and other NEOs to the company's performance. A company may include nonfinancial performance measures in this list if those measures are among the most important performance measures used by the company to link CAP to performance and the company has disclosed at least three financial performance measures (or fewer, if the company uses fewer than three).

Describing the Relationship Between Pay Versus Performance: Using values reflected in the PvP table, a company is required to describe: (i) the relationship between (a) the CAP to the CEO and the average total CAP to the other NEOs and (b) the company's TSR, its net income and the company-selected measure (CSM); (ii) how the company's TSR relates to the TSR of its peer group; and (iii) the relationship between (a) the CAP to the CEO and the average total CAP to the other NEOs and (b) any supplemental measures voluntarily included in the PvP table. Companies can describe these relationships through a narrative discussion, a graphic presentation or a combination of both.

Supplemental Disclosures

A company may supplement the disclosure by providing PvP disclosure (in tabular format or otherwise) based on other compensation measures such as "realized pay" or "realizable pay" if the company believes such supplemental disclosures 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 PvP disclosure. In practice, such supplemental disclosures were not common in the first year of PvP disclosure.

Covered Issuers

- All reporting companies that file proxies or information statements that require executive compensation disclosure are required to comply with this rule.
- SRCs 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. SRCs are not required to provide the peer group TSR or a CSM in the PvP table, or include a tabular list.
- Emerging growth companies (EGCs), FPIs and registered investment companies (other than business development companies) are entirely exempt from the disclosure requirements.
- A newly public company is required to file disclosure 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.

Time Period

Companies must disclose the applicable information for their five most recently completed fiscal years (with three years required in the first year of PvP disclosure, and adding another year of disclosure in each of the two subsequent annual filings). Therefore, in 2025, calendar-year public companies will generally include data for the full five fiscal years in their PvP tables.

Applicable Filings

- The PvP disclosure is required in any proxy or information statement that is required to include executive compensation disclosure, including those regarding the election of directors.
- The disclosure is not required in annual reports on Form 10-K, Securities Act registration statements or Exchange Act registration statements (*e.g.*, registration statements on Form S-1 for IPO companies).

PvP Lessons Learned From the 2024 Proxy Season

In 2023, the SEC released three sets of C&DIs relating to PvP disclosure. These C&DIs help clarify general disclosure and calculation requirements and provide guidance for identifying peer group(s) and CSM.[33] For a detailed summary of these C&DIs, please refer to our Matters To Consider for the 2024 Annual Meeting and Reporting Season checklist.[34] The SEC has not released any C&DIs related to PvP to date in 2024.

SEC Comment Letters on PvP Disclosure

The SEC staff is reviewing and issuing comment letters on PvP disclosure. Comment letters have generally focused on insufficient relationship disclosure, failure to describe how non-GAAP

[33] See our February 28, 2023, client alert "SEC Guidance Clarifies Some Issues Regarding Pay-Versus-Performance Disclosure, but Leaves Questions Unanswered"; September 29, 2023, client alert "SEC Staff Issues Additional Pay-Versus-Performance Compliance & Disclosure Interpretations"; and November 27, 2023, client alert "SEC Staff Issues New and Revised Pay-Versus-Performance Compliance & Disclosure Interpretations."

[34] See our December 12, 2023, checklist "Matters To Consider for the 2024 Annual Meeting and Reporting Season," pp. 19-21.

CSMs are calculated from audited financial statements, failure to include net income (loss) as reported in the company's audited GAAP financial statements, and inaccurate CAP table headings/descriptions, among other issues. Below are common triggers for SEC comment letters on PvP disclosure:

- **Insufficient Disclosure**
  - Failing to include CAP footnote disclosure for prior years if it is material to an investor's understanding of the information in the PvP table for the most recent fiscal year (*e.g.*, if the company corrects/revises CAP amounts disclosed for prior years but only includes CAP footnote disclosure for the most recent fiscal year).
  - Failing to clearly describe the relationship between (a) CAP and (b) TSR, net income, CSM and any supplemental performance measures/metrics.
    - Stating that no relationship exists is not compliant (even if a particular measure such as net income is not used in setting compensation).
- **Calculation Errors**
  - Using a date other than the required measurement point for TSR calculations (*i.e.*, the market close on the last trading day before the earliest fiscal year in the PvP table).
  - Valuing awards that vest during the year based on a year-over-year change, rather than valuing such awards as the difference between the fair value at the end of the prior fiscal year and the vesting date.
  - Calculating TSR based upon an initial fixed investment other than $100.
  - Failing to show each of the numerical amounts deducted and added in CAP calculations.
  - Using net earnings (loss) attributable to shareholders instead of the net earnings (loss) amounts reported in the company's audited GAAP financial statements. (SEC staff is reconciling against such figures as reported in company filings).
- **CSM Errors**
  - Using a CSM with a measurement period that spans multiple years, even if the measurement period does not exceed one year.
  - Failing to disclose how the CSM is calculated from the audited financial statements if the CSM is not a financial measure under generally accepted accounting principles.
    - Incorporation by reference to a separate filing will not satisfy the disclosure requirement, only a cross-reference within the proxy statement is appropriate.
  - Failing to include the CSM in the tabular list.
- **Peer Group Errors**
  - Using a broad market index (instead of a peer group that is a published industry or line-of-business index, or, if applicable, companies used in the compensation discussion/analysis).
  - Failing to present the peer group TSR information for each of the years in the PvP table using the peer group for the most recent year in the table, if the peer group has not changed from the immediately preceding fiscal year.
  - Failing to provide footnote disclosure explaining a change of peer groups and the cumulative TSR comparisons against the immediately preceding fiscal year.
  - Failing to list all companies that comprise the peer group if it is not a published industry or line-of-business index.
- **Graphic, Format and Miscellaneous Issues**
  - Failing to ensure that additional disclosures are clearly identified as supplemental, are not misleading and are not presented more prominently than the required PvP disclosure.
  - Failing to use clear descriptions or legends accompanying the relationship disclosure to explain information in the graph.
  - Failing to use table headings that accurately reflect the amounts used to calculate CAP (*e.g.*, describing as "year-over-year change in fair value of equity awards granted in prior years that vested in that year" because the rules require equity awards granted in prior years that vest during the relevant year to be valued as the difference between the fair value as of the end of the prior fiscal year and the vesting date, not "year-over-year" change in value).

Preparing for 2025 PvP Disclosure

In addition to reviewing the company's approach to PvP disclosure in the prior year and SEC guidance and comment letters, a company should generally consider the following as it prepares for the third year of PvP disclosure:

- Companies will need to include the full five years of data in their PvP tables (including the four years previously disclosed and data for the most recently completed fiscal year).
- Companies should update their CSMs as needed by evaluating the single most important financial performance measure (not otherwise included in the table) that the company used in the most recently completed fiscal year to link CAP to the company's performance.
- Companies should consider their tabular lists of financial performance measures and update as needed to reflect the most important financial measures (including the CSM) used for the most recent fiscal year to link CAP to company performance.

- Companies should confirm that their measurement period for their CSMs do not span years (*i.e.*, a CSM with a one-year period where the factor's calculated measurement period is more than one fiscal year).
- If a company will use a different peer group in its third-year PvP disclosure, the company must explain the reason for the change in a footnote and provide comparison information for both the old and the new peer groups.

Footnote disclosure of CAP adjustments is only required for the most recent fiscal year (if the company otherwise included CAP adjustments in prior years' disclosure and such prior years' disclosure is not otherwise material to an investor's understanding of the information in the PvP table for the most recent fiscal year).

Prepare for 2025 Pay Ratio Disclosures

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 (pay ratio).[35]

Companies must consider annually when preparing the mandatory pay ratio disclosures whether the same median employee may be used again for the upcoming year, and, if not, what new factors to use to identify the median employee.

Determining Whether To Use the Same Median Employee

Under Regulation S-K Item 402(u) Instruction 2, 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 2024, companies should consider the following:

- Companies that have been using the same median employee for three years will need to perform median employee calculations for fiscal year 2024.
- 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.
- Companies should carefully consider how to incorporate furloughed employees, if applicable, in the median employee pool.[36]
- Companies should evaluate how headcount changes may impact their abilities to exclude certain non-U.S. employees from their pay ratio calculations under the commonly relied upon de minimis exception in Item 402(u)(4)(ii): Companies should calculate whether non-U.S. employees (a) in the aggregate and (b) by jurisdiction newly constitute or no longer constitute more than 5% of the company's total employees.
  - 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 when identifying its median employee.
  - 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 2025 as the company used in 2024, 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 assess 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

[35] EGCs, SRCs and FPIs are exempt from the pay ratio disclosure requirement. Transition periods are also available for newly public companies.

[36] For information on how to incorporate furloughed employees into pay ratio calculations, see "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."

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 2024 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 pay for new special commissions limited to a company's sales team would.
- 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 role 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.

Pay Ratio Disclosure Impacts on Investors, Stakeholders and Proxy Advisors

In the final rule on pay ratio disclosure, the SEC explained that the pay ratio disclosure is intended to provide shareholders with a company-specific metric to assist their evaluation of the company's executive compensation practices.[37] Accordingly, proxy advisory firms ISS and Glass Lewis include company pay ratios as an informational data point in their company reports. However, ISS does not consider pay ratio disclosure when making voting recommendations.[38] Similarly, while Glass Lewis recognizes that CEO pay ratio has the potential to provide additional insight when assessing a company's pay practices, the ratio is not a determinative factor when Glass Lewis issues a voting recommendation.[39]

Although pay ratio disclosure rarely influences the voting recommendations made by proxy advisory firms at this time, companies should remain aware that investors and other stakeholders may be comparing CEO pay ratios among companies and year-over-year at individual companies when assessing pay practices and making voting decisions.

Prepare for New Option Grant Practice Disclosures

On December 14, 2022, the SEC adopted Regulation S-K Item 402(x), which requires companies (including SRCs and EGCs)[40] to disclose in annual reports on Form 10-K or proxy statements the company's policies and practices regarding the timing of awards of options in relation to the disclosure of material nonpublic information. Issuers will need to discuss:

- How the timing of awards is decided (*e.g.*, whether such awards are granted on a predetermined schedule).
- How material nonpublic information is considered, if at all, when determining the timing and terms of awards.
- Whether disclosure of material nonpublic information is timed to affect the value of such awards.

Issuers will also need to disclose in a new table any options granted in the last completed fiscal year to NEOs that were granted within four business days before or one business day after the (i) filing of a periodic report on Form 10-Q or 10-K or (ii) filing or furnishing of a current report on Form 8-K that discloses material nonpublic information (other than a current report disclosing a material new option award grant under Form 8-K Item 5.02(e)). The table should include the following:

- Each award, including the grantee's name, the date of the grant, the number of securities underlying the award, the option's per-share exercise price and the grant-date fair value.
- The percentage change in closing market price of the securities underlying each award on the trading day before and after disclosure of the material nonpublic information.

Issuers should provide the information in an Interactive Data File (*i.e.*, Inline XBRL) in accordance with the EDGAR Filer Manual.

[37] See the SEC's final rule release Pay Ratio Disclosure, Rel. Nos. 33-9877; 34-75610, p. 9 (Aug. 5, 2015), 80 Fed. Reg. 50104 (Aug. 18, 2015).

[38] See ISS' "United States Executive Compensation Policies Frequently Asked Questions" (updated Oct. 11, 2024), p. 25.

[39] See Glass Lewis' "2024 Benchmark Policy Guidelines – United States" (Nov. 16, 2023), p. 64.

[40] An SRC or EGC may limit the disclosures to (i) the company's principal executive officer (PEO), (ii) the two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year and (iii) up to two additional individuals who would have been the most highly compensated if serving as executive officers at the end of the last completed fiscal year.

Timing

These disclosure requirements are effective for the proxy statement (or Item 11 of Form 10-K) that covers the first full fiscal year beginning on or after April 1, 2023 (or October 1, 2023, for SRCs). Companies with a fiscal year ending December 31, 2024, should include disclosure in the proxy statement for the 2025 annual meeting of shareholders. Note that Item 402(x) disclosure relates only to grants of options, stock appreciation rights and "similar instruments with option like features" — it is not required for full-value awards such as RSUs or restricted shares.

Accounting Considerations

This disclosure of equity grant timing also includes accounting considerations. In November 2021, the SEC issued Staff Accounting Bulletin No. 120 (SAB 120), which addresses how companies should recognize and disclose the cost of providing "spring-loaded" equity awards to executives for purposes of Accounting Standards Codification (ASC) Topic 718.

A "spring-loaded award" is a share-based payment award made prior to (and proximate to) the company's disclosure of positive and previously material nonpublic information. Under SAB 120, a company that grants an equity award while in possession of positive material nonpublic information should consider whether adjustments to the following are appropriate when determining the fair-value-based measure of the award for purposes of ASC Topic 718:

- The current price of the underlying share; or
- The expected volatility of the price of the underlying share for the expected term of the share-based payment award. Significantly, SAB 120 applies to all equity awards and not just awards of options.

Taken together, the new Item 402(x) disclosure requirements and SAB 120 indicate that compensation committees should be aware of the timing of equity grants and the public disclosure context in which the grants are made. While the interplay of grant timing and disclosure of material nonpublic information is often the focus in the context of stock options and positive disclosure, a company that grants full-value awards that are sized based on a market value for the underlying shares — and makes such a grant in advance of the public announcement of material nonpublic information — should at a minimum maintain a record of the deliberation regarding whether those awards were sized appropriately given the potential impact of the announcement on the award value. Companies should also revisit their policies on the timing of option grants and compare these new disclosure requirements to existing Compensation Discussion & Analysis requirements under Regulation S-K Item 402(b)(2)(iv) (effective since 2006), which apply to both options and full-value awards.

Practical Considerations

Whether companies will react to this regulatory focus on grant timing by adopting policies with fixed timing of grants or through other means (such as making grants only during open trading windows and not during the four business days before or one business day after earnings reports or the filings of Forms 10-K, 10-Q or any 8-K disclosing material nonpublic information) remains to be seen. In anticipation of potential expanded scrutiny of the relationship between and the timing of material nonpublic information and equity awards, some companies are timing vesting and settlement of equity awards to occur during open trading windows.

Review Clawback Policies

Background

As required by the Dodd-Frank Act, in October 2022, the SEC adopted final rules (Rule 10D-1 of the Exchange Act) that directed the stock exchanges to establish clawback listing standards. The rule called for listed companies to develop and implement a policy providing for (i) the recovery of erroneously awarded incentive-based compensation received by current or former executive officers, as defined under Rule 16a-1(f) under Section 16 of the Exchange Act, and (ii) related disclosure obligations, even if there was no misconduct or failure of oversight on the part of an individual executive officer.[41]

Now that a full year has passed since the December 1, 2023, deadline to comply with implementation of the Dodd-Frank required policies, companies should reflect on and revisit their processes to use best practices going forward.

Operational Matters for Dodd-Frank Clawback Policies

Short-Term Action Items

- **File the clawback policy as an annual report exhibit and ensure the annual report cover page is updated.** The Dodd-Frank clawback rules require listed companies to file their clawback policies as exhibits to their annual reports on Form 10-K, 20-F or 40-F, as applicable. Companies should consider whether to voluntarily file any stand-alone supplemental clawback policies that exceed the Dodd-Frank clawback rules' requirements.
- **Review the look-back period.** While the rules provide for the recovery of erroneously awarded incentive-based compensation during the three years prior to the date of the accounting

[41] For a review of the Dodd-Frank Act clawback rules and related disclosure requirements, see our November 2, 2022, client alert "SEC Adopts Final Clawback Rules and Disclosure Requirements" and our June 16, 2023, client alert "SEC Approves Stock Exchange Rules for Dodd-Frank Clawbacks."

restatement, for the upcoming year, such look-back period does not apply, and instead is only required to apply to incentive-based compensation received on or after October 2, 2023. Therefore, the look-back period for 2025 will be less than the three-year requirement. For newly public companies, the look-back period is the later of October 2, 2023, or the date the company listed its securities on Nasdaq or the NYSE.

Medium-Term Action Items

- **Determine which executive officer compensation is incentive-based compensation.** The Dodd-Frank clawback rules apply to "incentive-based compensation," which is "any compensation that is granted, earned, or vested based wholly or in part upon the attainment of any financial reporting measure."[42] Before a potential accounting restatement arises, listed companies should ascertain which of their executive officer compensation arrangements qualify as incentive-based compensation.
  - Annual performance-based bonuses set based on achievement of financial reporting measures qualify as incentive-based compensation, as do many equity awards that vest based on achievement of performance conditions, such as performance-based restricted stock units that vest based on financial reporting measures such as total stockholder return.
  - Other types of executive officer compensation may feature incentive-based compensation more implicitly as an underlying variable, making aspects of the compensation incentive-based. For example, if a company's executive officer severance plan provides a pro rata bonus for the year of termination of employment that is paid based on actual company performance and is payable when bonuses are normally paid to actively employed executives, that element of severance could potentially be recoverable as erroneously awarded incentive-based compensation.
  - For companies that have a variety of *ad hoc* compensation arrangements with their executive officers, the importance of taking inventory of which arrangements would be incentive-based compensation is heightened. Such preparation can be crucial to positioning companies with complex and varying compensation arrangements to meet the requirement of recovering erroneously award incentive-based compensation "reasonably promptly" if their clawback policies are triggered.
  - Together with proxy statement reporting requirements and the challenges of administering executive compensation programs with many *ad hoc* executive compensation arrangements, the Dodd-Frank clawback rules offer another compelling reason to simplify and standardize a company's executive compensation program.

- **Reflect on the rationale for and documentation of forms of executive compensation.** The scope of the "incentive-based compensation" definition in the SEC's clawback rules means that time-based equity awards, bonuses and other forms of compensation that do not contain performance metrics can fall into the category of "incentive-based compensation" if they are granted in consideration of attainment of a past financial reporting measure. For example, if, in recognition of outstanding revenue performance during 2023, a company granted cash bonuses in 2024 that vest solely based on time-vesting criteria over the next three years, those bonuses would be incentive-based compensation. Therefore, companies should be aware that if they are documenting the rationale for executive compensation as based on prior financial reporting measure performance (whether implicitly or explicitly) in compensation committee resolutions, the Compensation Discussion & Analysis sections of their proxy statements, their executive offer letters or otherwise, that rationale could bring compensation under the umbrella of incentive-based compensation that would have otherwise been excluded from clawback policies, and that could meaningfully increase the scope of recoverable compensation if a clawback policy is triggered.
- **Reinforce the importance of an open line of communication between the accounting, finance, HR and legal functions.** If an accounting restatement occurs, various functions such as accounting, finance, HR and legal, along with the company's audit committee and compensation committee, will need to collaborate to determine (i) whether, and the extent to which, the accounting restatement triggers application of the clawback policy and (ii) the process for compensation recovery, if applicable.

  Clawback policies are typically thought to fall primarily under the purview of the HR and legal functions, but accounting and finance functions play crucial roles in identifying whether an event has occurred that has triggered the application of the clawback policy and how much compensation, if any, to recover. These primary functions should be made aware that an accounting restatement could trigger application of the clawback policy and that they have the obligation to alert the other functions if an accounting restatement due to the listed company's material noncompliance with any financial reporting requirement under the securities laws has occurred. In short, companies should ensure that their accounting, finance, HR and legal functions are all aware of and understand the company's clawback policy requirements and the need for prompt coordination and communication between company functions if an accounting restatement occurs.

[42] See the SEC's final rule release Listing Standards for Recovery of Erroneously Awarded Compensation , Rel. Nos. 33-11126; 34-96159 (Oct. 26, 2022), 87 FR 73076 (Nov. 28, 2022).

Long-Term/As-Needed Action Items

- **If stock price or TSR is an input to incentive-based compensation, consider which advisor(s) to engage.** The Dodd-Frank clawback rules do not prescribe how to determine the amount of incentive-based compensation to recover if the underlying financial performance metric is stock price or TSR. Determining how an accounting restatement impacts stock price and TSR may entail technical expertise, specialized knowledge and significant assumptions. Moreover, under Item 402(1)(i)(C) of Regulation S-K, if recovery is triggered under the company's clawback policy for a given fiscal year, the company would be required to disclose an explanation of the methodology it used to determine how much incentive-based compensation related to stock price or TSR to recover, and the company must maintain and provide documentation of the determination in accordance with the listing standard.

  Given the complexity of the analysis and the fact that aspects of the analysis will be disclosed externally, companies that have incentive-based compensation tied to stock price or TSR that experience an accounting restatement that triggers the company's clawback policy should consider engaging a third-party valuation expert to assist with evaluation and review.

- **Determine the means of recovering erroneously awarded incentive-based compensation.** Once erroneously awarded incentive-based compensation has been quantified, a company will need to assess how it intends to recover the amount, including the means and timing of recovery, as well as how the company plans to communicate any repayment obligation to its executive officers. Listed companies should keep in mind that certain states, such as California, have laws that generally prohibit the recovery of wages that have already been paid.[43] While the Dodd-Frank clawback rules are currently expected to preempt conflicting state law, litigation in the coming years may confirm whether and when the Dodd-Frank clawback rules apply and could indicate which means of recovery may reduce legal risk.

- **If the clawback policy is triggered, consider the tax consequences to the company and executive officers.** The Dodd-Frank clawback rules require recovery of erroneously awarded incentive-based compensation on a pre-tax basis. Therefore, if a company's clawback policy is triggered, the company will need to carefully assess how much of that compensation is or was properly deductible, and may be required to refund the Internal Revenue Service for deductions taken in previous years. Similarly, executive officers should work closely with tax advisers to determine how the officers' taxes are impacted by the clawback policy's application, including whether any offset is available under Section 1341 of the Internal Revenue Code of 1986, as amended, or otherwise, especially to the extent that the offset relates to erroneously awarded incentive-based compensation that was paid in a prior tax year.

  The SEC's final rules noted "the extent to which a tax system allows current adjustments for tax paid in prior periods under assumptions that later prove incorrect is a matter of tax policy outside the scope of this rulemaking … [but in] any event, we believe any resulting tax burden should be borne by executive officers, not the issuer and its shareholders."[44] Open questions about how compensation recovered under clawback policies should be taxed are expected to be answered in the coming years as companies begin implementing their clawback policies.

- **Disclose how the clawback policy has been applied during or after the last completed fiscal year.** The following disclosure requirements generally apply under Item 402(w) of Regulation S-K (or analogous disclosure provisions in the forms applicable to FPIs and listed funds), and the disclosure must be tagged in eXtensible Business Reporting Language (XBRL) format. Such disclosure applies in proxy or information statements that call for Item 402 disclosure or the listed company's annual report on Form 10–K (if not incorporated by reference to the proxy statement):

  - If during or after the last completed fiscal year, the listed company was required to prepare a restatement that required recovery of erroneously awarded incentive-based compensation under the company's clawback policy, or there was an outstanding balance as of fiscal year-end of erroneously awarded incentive-based compensation to be recovered from a previous application of the policy, the listed company is required to disclose:

    i. (The date it was required to prepare the restatement.

    ii. The aggregate dollar amount of erroneously awarded incentive-based compensation, including an analysis of how the amount was calculated (with enhanced disclosure if the financial reporting measure related to stock price or TSR).

    iii. The aggregate dollar amount of erroneously awarded incentive-based compensation that remains outstanding at the end of the last completed fiscal year; provided that alternative disclosure would be required if the aggregate dollar amount of erroneously awarded incentive-based compensation had not yet been determined.

  - If recovery would be impracticable in accordance with the narrow exceptions in the Dodd-Frank clawback rules, the company is required to briefly disclose why recovery was

[43] See California Labor Code § 221.

[44] See the SEC's final rule release Listing Standards for Recovery of Erroneously Awarded Compensation, Rel. Nos. 33-11126; 34-96159, p. 78 (Oct. 26, 2022), 87 FR 73076 (Nov. 28, 2022).

not pursued and the amount of recovery foregone for each current and former named executive officer and for all other current and former executive officers as a group.

- For each current and former named executive officer for whom, as of the end of the last completed fiscal year, erroneously awarded incentive-based compensation has been outstanding for 180 days or longer since the date the listed company determined the amount owed, the company should disclose the dollar amount of outstanding erroneously awarded incentive-based compensation due from each such individual.
- If the company was required to prepare a restatement during or after its last completed fiscal year and concluded that recovery of erroneously awarded incentive-based compensation was not required under the clawback policy, the company is required to briefly disclose the reasoning behind that conclusion.
- Any recoupment of compensation must be included in the company's Summary Compensation Table by subtracting the amount recovered from the amounts reported in that table for that year and quantifying the amount recovered in a footnote.

Checkboxes on the Cover Page of Annual Reports

Companies must determine whether the checkboxes (copied below) on the cover page of the annual report are applicable regarding (i) the correction of accounting errors and (ii) a clawback analysis. These disclosures on the cover page of the Form 10-K, 20-F or 40-F must be tagged in XBRL format.

☐ 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).

Box 1: Companies should perform a two-step process to determine whether to check Box 1:

1. Did the company correct any errors or make revisions to a previously issued financial statement or footnotes? The term "revision" encompasses (i) "Big R restatements," which correct a material error in the previously issued financial statement; (ii) "little r revisions or restatements," which correct an error that was immaterial to the previously issued financial statement (but correcting the error in the current period would materially misstate the current period); **and** (iii) any other changes.
2. Were such corrections or revisions due to accounting errors under Accounting Standards Codification (ASC) 250?
   - Revisions due to the adoption of an accounting principle that applied to previous periods (*i.e.*, retrospective changes) are not considered accounting errors.
   - Out-of-period adjustments are also not in this category.
   - Correcting errors in the application of GAAP or other mathematical errors are considered accounting errors.

Box 2: Do any of those error corrections involve restatements that require a company to determine whether it must recover incentive-based compensation under the company's clawback policy?

Clawbacks Beyond the Dodd-Frank Requirements — Considering Whether To Amend or Supplement the Clawback Policy

Compensation committees (or boards of directors, if applicable) should consider at least annually whether to update the clawback policy in response to market and/or industry trends, proxy advisory firm guidance, other clawback rules and other factors that arise in the coming years as the Dodd-Frank clawback rules are implemented.

- Recent surveys have reported that a significant number of public companies have recoupment policies or provisions that exceed the Dodd-Frank requirements.[45] One survey of approximately 400 S&P 500 companies revealed that about 70% of company clawback policies disclosed before May 7, 2024, have at least one recoupment trigger besides accounting restatements.[46] Examples of the expanded triggers include: (i) breach of legal requirements or company policy, (ii) breach of fiduciary duty or fraud, (iii) misconduct with reputational or financial harm, (iv) administrative enforcement, (v) termination or criminal resolutions (*e.g.*, charges of fraud, embezzlement and theft) and (vi) inappropriate conduct.[47] A separate survey of large cap companies found that 66% of the respondents reported having recoupment provisions covering a broader population than required by Dodd-Frank, and 67% of the respondents reported having recoupment provisions covering discretionary cash and/or time-based equity awards.[48] A third survey noted that

[45] See DragonGC's report "Compensation Clawbacks Report" (May 7, 2024), FW Cook's report "Clawback Policies: Beyond Compliance" (Sept. 13, 2024) and Meridian Compensation Partner's report "2024 Corporate Governance and Incentive Design Survey" (Sept. 26, 2024).

[46] See DragonGC's report "Compensation Clawbacks Report" (May 7, 2024).

[47] *Id.*

[48] See FW Cook's report "Clawback Policies: Beyond Compliance" (Sept. 13, 2024).

companies that have expanded recoupment policies typically provide for discretionary authority to recoup compensation where the recoupment is beyond the requirements of the Dodd-Frank Act.[49]

- Glass Lewis' United States 2025 Benchmark Policy Guidelines, published in November 2024, strongly recommend that companies maintain clawback policies that permit recovery in circumstances that extend beyond the Dodd-Frank clawback rules' requirements. Specifically, Glass Lewis stated that recovery policies should permit companies to recover variable incentive payments (whether time-based or performance-based) "when there is evidence of problematic decisions or actions, such as material misconduct, a material reputational failure, material risk management failure, or a material operational failure, the consequences of which have not already been reflected in incentive payments and where recovery is warranted" and regardless of whether the executive officer was terminated with or without cause.[50]
- Glass Lewis also expects robust disclosure about a company's decision not to pursue recovery under a clawback policy, and, if applicable, how the company has corrected the disconnect between executive pay outcomes and negative impacts of executives' actions on the company.[51] The absence of such enhanced disclosure could affect Glass Lewis' overall say-on-pay recommendation.[52]
- Similarly, in October 2024, ISS released a new FAQ on Executive Compensation Policies. ISS noted that for a listed company to be perceived as having a robust clawback policy, the company's clawback policy "must extend beyond the minimum Dodd-Frank requirements and explicitly cover all time-vesting equity awards."[53] Clawback policies that do not cover all time-vesting equity awards will not be deemed robust.
- The impact of the DOJ's Criminal Division's three-year Pilot Program Regarding Compensation Incentives and Clawbacks remains to be seen. Under the pilot program, where a criminal resolution is warranted, public and private companies may qualify for reduced fines if they have implemented a compensation recovery program that permits recovery from employees who engaged in misconduct in connection with the conduct under investigation, or from others who both had supervisory authority and knew of, or were willfully blind to, the misconduct.[54]

[49] See Meridian Compensation Partner's report "2024 Corporate Governance and Incentive Design Survey" (Sept. 26, 2024).

[50] See Glass Lewis' "2025 Benchmark Policy Guidelines – United States" (Nov. 14, 2024).

[51] See *id.*

[52] See *id.*

[53] See ISS's United States Executive Compensation Policies Frequently Asked Questions (updated Oct. 11, 2024).

[54] See the Department of Justice's "The Criminal Division's Pilot Program Regarding Compensation Incentives and Clawbacks" (March 3, 2023).

CEOs and chief financial officers (CFOs) remain subject to the clawback provisions of the Sarbanes-Oxley Act of 2002 (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. If the Dodd-Frank clawback policy and SOX cover the same recoverable compensation, the CEO or CFO is not subject to duplicative reimbursement. Recovery under the Dodd-Frank clawback will not preclude recovery under SOX to the extent any applicable amounts have not been reimbursed to the listed company.

Evaluate Hart-Scott-Rodino Act Implications on Executive Compensation

Officers and directors who hold at least $119.5 million[55] in voting securities in their companies should consider the need to make Hart-Scott-Rodino (HSR) filings whenever these individuals increase their holdings through an acquisition of voting securities. A company's annual preparation of its beneficial ownership table provides a regular opportunity to assess whether any of the company's officers or directors may be approaching an HSR filing threshold. HSR counsel can advise when exemptions are available to obviate the need to file notifications.

For HSR purposes, an "acquisition" is the receipt of new voting securities, whether formally (technically) purchased or not. An acquisition is considered to occur only when the officer or director obtains beneficial ownership of the shares (*i.e.*, receives the present right to vote for the board of directors). Therefore, acquisitions may include, without limitation:

- Grants of fully vested shares or restricted stock as a component of compensation.
- The vesting or settlement of time-based or performance-based restricted stock units.
- The exercise of stock options.
- Open market purchases of shares.
- The conversion of convertible nonvoting securities into voting shares.

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

[55] The HSR Act establishes a set of notification thresholds that are adjusted annually based on changes to the gross national product. The initial filing threshold for 2024 is $119.5 million and new thresholds will be established in the first quarter of 2025.

shares do not constitute "voting securities" prior to vesting, settlement or exercise and thus do not require reporting under the HSR Act.

Generally, an "acquisition" can trigger a filing obligation. For example, an annual grant of voting securities pursuant to an officer's or director's long-term incentive plan can require HSR Act filings to be completed in advance of the grant, even if the value of the granted shares does not exceed a filing threshold and if the total percentage amount to be held after closing of the grant does not significantly increase the person's aggregate holdings.[56] By contrast, a filing requirement is not triggered solely by an increase in the value of an officer's existing holdings from $115 million to $120 million, for example, as a result of share price appreciation. However, if such officer subsequently wanted to exercise a stock option to acquire more voting securities, an HSR obligation could be triggered because the value of the officer's current holdings already exceeds the filing threshold.

The filing requirement is triggered whenever — after the acquisition of voting securities — the aggregate value of an officer or director's holdings of voting securities in the company meets or exceeds an HSR filing threshold (the lowest of which is triggered by exceeding $119.5 million).[57] The value of the proposed acquisition[58] is added to the current value, not the historical purchase price, of current holdings to determine whether a threshold has been met or crossed.

Higher HSR reporting thresholds require additional HSR filings if an acquisition of voting securities causes an officer's or director's holdings to meet those thresholds.[59] The next two filing levels are currently $239.0 million or higher and $1.195 billion or higher. An HSR filing is also required if the acquisition would cause the officer or director to own 25% of the issuer's outstanding voting securities, if that issuer is valued at greater than $2.390 billion. Similarly, an HSR filing is required if the acquisition would cause the officer or director to own 50% of the issuer's outstanding voting securities, if that issuer is valued at greater than $119.5 million.

If an HSR filing is required, both the individual and the company must make a filing and wait 30 days before completing the triggering acquisition. The filer has one year from the time of clearance to cross the applicable acquisition threshold and may make additional acquisitions for five years after the end of the waiting period with no further HSR filings; provided that the filer does not acquire sufficient shares to cross the HSR threshold above the level for which the notification was filed.

The Federal Trade Commission (FTC) and the DOJ have historically followed an informal "one free bite at the apple" enforcement practice in response to certain missed HSR filings. This "free bite" may address all prior missed filings that occurred before the corrective filing. As a result, an officer or director who inadvertently failed to make a required HSR filing should notify the agencies by submitting a corrective filing detailing previous acquisitions, explaining the missed filing, and detailing how they plan to track and meet filing obligations in the future.

However, the FTC and the DOJ have otherwise pursued enforcement actions and may impose material civil penalties of up to $51,744 per day[60] 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.[61] Therefore, officers and directors who have made corrective filings should be especially vigilant and consult HSR counsel regularly before a potential "acquisition" event is expected to occur.[62]

[56] Note that an increase in a shareholder's voting power (*i.e.*, holding or acquiring voting securities that provide more than one vote per share) can trigger an HSR reporting obligation, even if new shares are not technically received. This can happen when there is a change in the voting power of a class of securities that are already held by an officer or director. HSR counsel can analyze the impact of this type of change on a company's filing requirements.

[57] Under 16 C.F.R. § 801.1(h), only the lowest threshold must be exceeded. All others must merely be met.

[58] Several rules govern the valuation of proposed acquisitions. Publicly traded voting securities are valued at the higher of the market price and the officer or director's acquisition price. Nonpublicly traded voting securities are valued at the acquisition price, but if this has not been determined, at fair market value.

[59] See the FTC's New HSR Thresholds and Filing Fees for 2024 (Feb. 5, 2024) for all current notification thresholds.

[60] The HSR civil penalty amount is adjusted by the FTC each January based on the percentage change in the consumer price index. The maximum civil penalty for an HSR violation in 2024 is $51,744 per day, and the new maximum will be established in January 2025.

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

[62] The FTC additionally recently released a new final rule, "RIN 3084-AB46: Premerger Notification; Reporting and Waiting Period Requirements," relating to premerger filings. HSR filings must comply with this new rule beginning in mid-to-late January 2025. HSR and antitrust counsel can advise when exemptions are available to obviate the need to file notifications under this new rule.

Annual Meeting and Corporate Governance Trends

Revisit Disclosure Controls and Procedures for Related-Party Transactions

SEC rules require public companies to maintain and regularly evaluate the effectiveness of DCPs. CEOs and CFOs also must certify the effectiveness of the company's DCPs on a quarterly basis. In addition, several SEC enforcement actions have alleged that companies failed to maintain adequate DCPs. These actions highlight the importance of periodically reassessing DCPs and considering any necessary changes to support the consistency, accuracy and reliability of required and voluntary disclosures.

Recent SEC Enforcement Actions

Companies should carefully analyze potential related-party transactions. While Item 404 of Regulation S-K provides the parameters of transactions that are required to be disclosed, fact patterns may not fit neatly into or clearly fall outside of those parameters. Accordingly, when assessing specific facts that may constitute a related-party transaction, companies should consider the following:

- **Participation in a transaction.** In September 2023, the SEC settled an enforcement action against a company for failure to disclose a transaction in which the company was not a party to the contract, but the company approved the sale and secured a number of terms in the contract between a shareholder and a director. The SEC alleged that the sale qualified as a related-person transaction requiring disclosure in the company's Form 10-K because the director had a financial interest in the transaction, and the company acted as a participant.
- **Family relationships and personal expenses.** In March 2024, the SEC settled an enforcement action against a company for failure to disclose multiple transactions involving payments to family members of executives and outstanding reimbursements for personal expenses owed to the company by certain executives. The SEC order found that the failure to disclose these related-party transactions between 2019 and 2022 violated reporting and proxy solicitation provisions of the Exchange Act.

Takeaways

- These settlements underscore the importance of companies conducting a thorough, fact-based analysis when a potential related-party transaction arises.
- Companies should be particularly diligent about tracking payments, including reimbursements, between the company and its directors and executive officers and monitoring any family or other relationships between directors and executive officers and other company personnel.
- Additionally, companies should closely review the company's role in a potential related-person transaction, even when the company itself is not party to a particular transaction or agreement. Facilitation, approval of terms and other involvement in the process may render the company a participant in the transaction.

Examine D&O Questionnaires and Consider Personal Relationships in Director Independence Determinations

A recent SEC enforcement action serves as a reminder that all relevant facts and circumstances — including personal relationships — should be considered when making independence determinations. In light of this enforcement action, companies should review their D&O questionnaires to ensure the prompts are designed to capture such relationships.

Recent Enforcement Action

In September 2024, the SEC announced that it settled charges against a former director of a public company for violating proxy disclosure rules. The former director caused the company's proxy statements to contain materially misleading statements by concealing his close personal friendship with a high-ranking company executive and falsely standing for election as an independent director.

According to the SEC's complaint, the former director maintained a close personal friendship with a company executive and frequently vacationed together with the executive and both their spouses. The former director paid over $100,000 in expenses for the executive and his spouse to join the director on international vacations. The former director allegedly never informed the board of this close personal relationship during periodic director independence assessments or otherwise — in fact, the former director responded "No" to a question in the company's D&O questionnaire that asked whether the director had "any other relationship" with the company or management. He also encouraged the executive not to tell anyone at the company about their relationship.

As a result, the board was unaware of this personal relationship, and the company disclosed in its annual meeting proxy statements that the former director was independent. The SEC alleged that the former director was personally liable for material misstatements in the proxy statements. Without admitting or denying the allegations, the former director agreed to be permanently enjoined from further violations of the proxy provisions of the Exchange Act, to pay a civil penalty of $175,000 and to observe a five-year officer-and-director bar.

Assessing D&O Questionnaires

- At least annually, companies should review their D&O questionnaires to confirm the forms reflect recent regulatory developments.
- Companies should confirm their questionnaires appropriately capture relationships between directors and the company or management that may be relevant to director independence, as well as board committee eligibility requirements.
  - For example, the D&O questionnaire may ask about any such relationships, including close friendships or business relationships. Although this question is typically directed to nonemployee directors, companies also may consider soliciting similar information from officers.

Assess the Impact of Proxy Advisory Voting Guidelines

Proxy advisory firm Glass Lewis has updated its voting guidelines for the 2025 annual meeting season,[63] and ISS has proposed updates to its voting guidelines.[64] Companies should assess the potential impact of these updates when considering changes to their corporate governance practices, shareholder engagement and proxy statement disclosures. Companies should also keep in mind that ISS often includes policy updates in its final voting policy that did not appear in the proposed updates.

Glass Lewis Updates for 2025[65]

Glass Lewis' updated voting guidelines for 2025 include new and updated sections as well as clarifying amendments. The updates are summarized below.

- **Board Oversight of AI:** Given the potential risks associated with companies' rapid development and growing use of AI technologies, Glass Lewis now expects boards to track, understand and take steps to mitigate exposure to any material risks that could arise from a company's use or development of AI.

  In the absence of material incidents related to a company's use or management of AI-related issues, Glass Lewis generally will not make voting recommendations based on a company's oversight of, or disclosure concerning, AI-related issues. If, however, there is evidence that insufficient oversight and/or management of AI technologies has resulted in material harm to shareholders, Glass Lewis (i) will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of AI-related risks, (ii) will evaluate the board's response to, and management of, this issue as well as any associated disclosures and (iii) may recommend against certain directors if the board's oversight, response or disclosure concerning AI-related issues are deemed insufficient.
- **Board Responsiveness to Shareholder Proposals:** Glass Lewis' revised policy on board responsiveness to shareholder proposals now provides that when shareholder proposals

[63] See Glass Lewis' 2025 Benchmark Policy Guidelines – United States (Nov. 14, 2024) and 2025 Benchmark Policy Guidelines – Shareholder Proposals & ESG-Related Issues (Nov. 14, 2024).

[64] See ISS' Proposed ISS Benchmark Policy Changes for 2025 (Nov. 18, 2024). ISS' final proxy voting guidelines for 2025 are expected to be announced in mid-December 2024. For ISS' current proxy voting guidelines, see ISS' Proxy Voting Guidelines – United States (Jan. 2024) and Sustainability Proxy Voting Guidelines – United States (Jan. 2024).

[65] For compensation-related updates in Glass Lewis' 2025 guidelines, see the "Incorporate Lessons Learned From the 2024 Say-on-Pay Votes and Compensation Disclosures and Prepare for 2025 Pay Ratio Disclosures" section of this checklist.

receive significant support (generally more than 30% but less than a majority of votes cast), Glass Lewis will generally take the view that boards should engage with shareholders on the issue and provide disclosure addressing shareholder concerns and outreach initiatives. In the case of shareholder proposals that receive support from a majority of votes cast, the guidelines continue to express an expectation that companies implement the proposal and/or engage with shareholders on the issue and provide sufficient disclosures to address shareholder concerns.

- **Reincorporation:** Glass Lewis revised its policy on reincorporation proposals to provide that it will review all proposals to reincorporate to a different state or country on a case-by-case basis. The revised policy clarifies that Glass Lewis will consider several factors when evaluating the impact of reincorporation on shareholder rights, including (i) changes in corporate governance provisions, (ii) material differences in corporate statutes and legal precedents, (iii) differences in fiduciary duties standards and (iv) whether the new jurisdiction is considered to be a "tax haven."
- **AI-Related Shareholder Proposals:** Glass Lewis' updated guidelines on shareholder proposals and ESG-related issues now state that companies should provide sufficient disclosure to allow shareholders to broadly understand how the company is using AI in its operations and what ethical considerations, if any, have been incorporated in its use of this technology. Glass Lewis will carefully evaluate all shareholder proposals related to companies' use of AI technologies and will make recommendations on these proposals on a case-by-case basis. When evaluating these proposals, Glass Lewis will review the request of the proposal, the disclosure provided by the company and its peers regarding their use of AI, and the oversight afforded to AI-related issues. Glass Lewis will also evaluate any lawsuits, fines or high-profile controversies concerning the company's use of AI as well as any other indication that the company's management of this issue presents a clear risk to shareholder value.

ISS Proposed Updates for 2025

ISS is soliciting comments on three relatively minor policy updates for 2025. The proposed updates are summarized below.

- **Poison Pills:** Under its current guidelines, ISS conducts a case-by-case evaluation of whether a board's actions in adopting a short-term poison pill were reasonable or should be deemed a governance failure. ISS' proposed updates seek to increase transparency of the factors considered during this evaluation by expanding and adding new factors already considered under the category of "other factors as relevant." The following are the expanded or newly listed factors:
  - The trigger threshold and other terms of the pill.
  - The context in which the pill was adopted (*e.g.*, the company's size and stage of development, sudden changes in its market capitalization, and extraordinary industrywide or macroeconomic events).
  - The company's overall track record in corporate governance matters and responsiveness to shareholders.
- **Special Purpose Acquisition Company (SPAC) Extension Proposals:** ISS' current guidelines provide that it will vote on SPAC extension proposals on a case-by-case basis, taking into account the length of the extension, the status of any pending transaction, any added incentive for non-redeeming shareholders and prior extension requests. Due to the proliferation of "zombie SPACs" that have experienced heavy shareholder redemptions and leave minimal funds in the trust account, ISS' proposed updates would codify its current practice. As proposed, ISS (i) would generally support requests to extend the termination date by up to one year from the original termination date (inclusive of any built-in extension options, and accounting for prior extension requests) and (ii) may consider any added incentives, business combination status, other amendment terms and use of money in the trust fund to pay excise taxes on redeemed shares (if applicable).
- **Natural Capital-Related and/or Community Impact Assessment Proposals:** ISS' proposed update would broaden the existing title of its current policy, "General Environmental Proposals and Community Impact Assessments," to be: "Natural Capital-Related and/or Community Impact Assessment Proposals." This proposed update is intended to help align the policy with the evolving focus seen in shareholder proposals on topics such as natural capital and community impact risks and the nature-related and community impact assessment proposals companies may receive in the coming years. No material changes to the existing policy application under ISS' current guidelines are otherwise proposed.

Review Shareholder Proposal Trends and Developments

After two proxy seasons in which the SEC received and granted fewer no-action letters to exclude shareholder proposals, requests surged in 2024, and the SEC granted a higher percentage than in 2023. Below is a brief summary of observations relating to Exchange Act Rule 14a-8 and some considerations for the 2025 proxy season.

2024 Proxy Season Summary

Surge in No-Action Requests

During the 2024 proxy season, noteworthy patterns emerged. Companies submitted approximately 50% more no-action requests than they did during the 2023 season — with greater overall success, with the staff of the SEC's Division of Corporation Finance granting more than two-thirds of the 2024 requests (excluding withdrawals). The season followed a tumultuous one in 2022, when the staff denied a significant number of no-action requests and the grounds for obtaining no-action appeared to have narrowed, and 2023, when companies appeared less willing to challenge certain proposals.

Although the staff's decision-making process on certain no-action requests remains opaque, the 2024 no-action activity shows that the process remains a viable mechanism to exclude many shareholder proposals. Companies should note that outcomes will remain dependent on the actual proposal language, and there inevitably will be year-over-year variation in success rates.

Even with a new administration, no sea change is expected in the staff's views on shareholder proposals for the 2025 season, as SEC leadership changes and any changes in overall direction for the staff reviewing no-action requests likely will occur near the end of the season.

Highlights of Specific Proposal Topics

Environmental and Social (E&S) Proposals: For the eighth year in a row, E&S proposals outnumbered governance proposals, with 619 E&S proposals submitted, compared to 278 governance-focused proposals. Unsurprisingly, more E&S proposals than governance proposals ultimately landed on companies' ballots, with 384 E&S proposals versus 178 governance proposals voted on.

- Consistent with the general trend of decreased support for E&S shareholder proposals in 2024, only three E&S proposals received majority support, down from seven in 2023.
- Notably, despite the trend of decreasing support in recent years, 205 environmental proposals were submitted to companies, which addressed a broad range of topics.
- Average support for environmental proposals that appeared on ballots continued to decline — 18.3% in 2024 compared to 20.5% in 2023.
- Proposals addressing social issues remained flat in 2024 over 2023, with 414 social proposals submitted compared to 412 in 2022. The number of social proposals voted on increased to 266 proposals in 2024 versus 244 proposals in 2023.
  - Average support for these social proposals decreased to 15% in 2024 compared to 18% average support for social proposals in 2023.
  - Only one social proposal received majority support in 2024, compared to the five proposals that received majority support in 2023.

Diversity, equity and inclusion (DEI) issues remained a focal point in proposals but also continued to see decreased support from shareholders. For example, proposals calling for companies to conduct third-party racial or civil rights equity audits achieved average support of only 7% and none of them received majority support, compared with 22% average support and none that received majority support in 2023. In contrast, in 2022, these proposals received 44.9% average support, with eight receiving majority support.

Governance Proposals: Compared to the 2023 season, fewer proposals concerning governance topics were voted on: 178 in 2024 compared to 199 in 2023.

- 45 governance proposals received majority support in 2024, a significant increase from 23 in 2023.
- The most popular governance topic in 2024 was requests to eliminate supermajority voting provisions in charters and bylaws, with 41 proposals coming to a vote. Thirty (30) of these proposals received majority support in 2024 and average support was 72%, up from the 58% average support these proposals received in 2023.
- 48 independent board chair proposals proceeded to a vote in 2024, with average support of 30% and none receiving majority support.
- 31 special meeting-related shareholder proposals proceeded to a vote in 2024, with average support of 43% and five receiving majority support.
  - Submission and support for this proposal topic decreased from 2023, when 42 special meeting proposals proceeded to a vote, achieving average support of 35%. Eight of these proposals received majority support in 2023.
- Eight written consent proposals proceeded to a vote in 2024, with average support of 37% and none receiving majority support.
  - This was similar to 2023, when seven written consent proposals proceeded to a vote with average support of 34% and one proposal receiving majority support.

Executive Compensation Proposals: The number of executive compensation-related proposals submitted in 2024 decreased to 72 from 82 in the 2023 proxy season. The number of executive compensation-related proposals that moved forward to a vote also decreased — 56 in 2024 from 68 in 2023. Once again, the proposals voted on in 2024 had lower average support of 15%, compared to 22% in 2023. Notably, none of the compensation-related proposals received majority support in 2024.

The most common executive compensation proposal type requested adoption of a policy that the board of directors seek shareholder approval of any senior manager's new or renewed pay package that provides for severance or termination payments — including the vesting of equity awards — with an estimated value exceeding 2.99 times the sum of the executive's base salary and short-term bonus. There were 30 of these proposals voted on in 2024 and they received average support of 16%, with none receiving majority support.

No-Action Letter Highlights

Companies successfully asserted ordinary business as a basis for exclusion. Consistent with prior seasons, the "ordinary business" basis for exclusion was the ground companies asserted most frequently. Aside from the "micromanagement" prong of this basis for exclusion (discussed below), the staff concurred with more than half of the ordinary business arguments.

The staff granted relief on ordinary business grounds to proposals such as those relating to healthy hospital food, airline in-flight meal options, relocation of a company's headquarters and advertising matters, all of which seem unquestionably "ordinary."

In contrast, the staff found that many proposals transcended ordinary business, and denied relief for proposals requesting:

- A report on the use of artificial intelligence and the adoption of any ethical guidelines relating to this activity.
- Creation of a board committee on corporate financial sustainability to oversee the company's policy positions, advocacy and charitable contributions.
- A report on cost savings from the adoption of a smoke-free policy for the company's properties.
- A moratorium on sourcing minerals from deep sea mining.
- Establishment of wage policies, consistent with fiduciary duties, reasonably designed to provide workers with the minimum earnings necessary to meet a family's basic needs.

Micromanagement arguments were often successful. As articulated by the staff, whether a proposal micromanages a company is determined by the level of granularity sought by a proposal and the extent to which it inappropriately limits board or management discretion.

On that basis, the staff granted relief on micromanagement grounds, permitting companies to exclude proposals that requested:

- A report on the benefits and disadvantages of committing not to sell products containing titanium dioxide sourced from the Okefenokee wetlands.
- A living wage report including the number of workers paid less than a living wage, broken down by specific categories and listing for each category the aggregate amount by which pay falls short of a living wage.
- A report on divestitures of assets with a material climate impact, including whether each purchaser discloses its greenhouse gas (GHG) emissions and has specified GHG reduction targets.
- A list of corporate charitable contributions of $5,000 or more for posting on the company's website, including any material limitations or monitoring of the contributions.

Violation of state law was a valid basis for exclusion. A shareholder proposal may be excluded if implementation of the proposal would cause the company to violate any state, federal or foreign law to which it is subject. Approximately three-quarters of no-action requests asserting this basis for exclusion were granted.

- For example, funds affiliated with the United Brotherhood of Carpenters launched a new proposal campaign intended to enhance majority voting standards in director elections. The proposals sought adoption of bylaws mandating acceptance of a director's resignation where the director fails to receive majority support, absent "compelling" reasons. If the resignation is not accepted, the requested bylaw would require automatic acceptance of the director's resignation if the director fails to receive majority support a second, consecutive time.

  Companies incorporated in Delaware and North Carolina, relying on the legal opinions of local counsel, successfully asserted that adoption of such a bylaw would cause directors to violate their fiduciary duties. To date, however, companies incorporated in New York and Virginia have not been successful in excluding this proposal.
- In contrast to the outcome for most of those proposals, the staff denied no-action requests to exclude proposals seeking a governance guideline or policy providing that a board would not renominate at the next annual meeting any director who failed to receive majority support in an uncontested election.

Procedural arguments often proved to be effective. Companies generally were successful excluding proposals on procedural grounds, with a couple of noteworthy exceptions:

- A majority of the unsuccessful procedural arguments related to a specific proponent who submitted proposals to numerous companies, relying in each case on a broker letter affirming the proponent's ownership for the required period under Rule 14a-8 even though the shareholder's account with this particular broker did not cover that full ownership period. Historically, proponents would have to provide letters from different brokers

covering each portion of the period so that, together, the multiple letters covered the full period. In this case, the broker relied on information provided by a previous broker.

In response to numerous no-action requests, the staff rejected the argument that the proponent had failed to provide adequate proof of ownership and that the one broker could not verify ownership for the entire period. The staff stated that the proponent had supplied the necessary evidence of eligibility and, further, that Rule 14a 8 does not require submission of multiple broker letters in this context.

- In another surprising outcome, a proponent provided proof of ownership from November 14, 2022, through November 13, 2023. Because that year's span was short one day, the company asserted, consistent with precedent, that the proponent failed to satisfy the one-year ownership requirement prior to submission of the proposal. The staff denied relief, stating its view that the proponent's proof of ownership covered the one-year period required by Rule 14a-8.
- Finally, sending an important reminder to companies, the staff denied relief where a company, in response to a proposal that was not accompanied by proof of ownership, sent the proponent an email requesting proof of ownership rather than a formal deficiency notice detailing the procedural deficiency and how to cure the defect.

Substantial implementation arguments remain uphill battles. The staff continues to apply a narrow lens to substantial implementation arguments, granting relief to only one-third of those arguments. In many cases, any deviation from the proposal's request resulted in a denial of relief on this basis.

In the case of proposals to adopt a simple majority-of-votes-cast voting standard in charters and bylaws — one of the most common proposal topics in the 2024 season — the staff continues to make fine distinctions that are not entirely transparent.

- On one hand, the staff granted relief to some companies that had eliminated higher voting standards in charters and bylaws: Where proposal language alluded to higher voting standards that are defaults under state law (but that can be changed by a company), the staff stated that it "generally will not consider voting standards implicit in state law unless the [p]roposal identifies the specific state law provisions at issue."
- On the other, the staff rejected substantial implementation arguments where the company charter had a majority-of-outstanding-shares provision (*i.e.*, higher than a simple majority standard) that was required by state law.

Questioning the competence of a director standing for election occasionally led to exclusion. Many shareholder proposals contain supporting statements that are critical of the company's board of directors or that criticize, for example, the asserted lengthy tenure of a lead independent director. Generally, those criticisms do not rise to the level to serve as grounds for excluding a proposal. However, occasionally a company can successfully exclude a proposal for questioning the competence, business judgment or character of a nominee for election.

- The staff granted relief to the sole no-action request submitted this season on this basis. The proposal sought adoption of an independent chair policy, and the supporting statement asserted that the company's lead director did not "seem to have enough stature to be a lead director" given his 30-year career at a firm with less than $5 million of annual revenue compared to the company's $26 billion of revenue.

This request serves as a reminder that, although scrutiny of the board is not a common basis for proposal exclusion, there are limits to what a shareholder proponent under Rule 14a-8 can say about directors standing for election.

Updated Submission Process for No-Action Requests

As a reminder, beginning with the 2024 proxy season, the staff announced a new submission process for shareholder proposal no-action requests and all other communications. Companies must submit these requests and related correspondence using the online shareholder proposal form on the SEC's website. The SEC no longer accepts emailed materials. Companies must still forward relevant correspondence to proponents (by mail or email).

Proposed Amendments to Rule 14a-8

As discussed in detail in our July 15, 2022, client alert "SEC Proposes Amendments to the Shareholder Proposal Rules," in July 2022, the SEC proposed amendments that would modify the standards for exclusion of a proposal under the "substantial implementation," "duplication" and "resubmission" grounds in 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.

While the SEC's current rulemaking agenda indicates final action on the proposed amendments is expected in April 2025,[66] the change in administration may affect support for the rules as proposed.

[66] See the SEC's 14a-8 Amendments (Spring 2024).

Revisit Advance Notice Bylaw Provisions

Overview

Advance notice bylaws require shareholders submitting director nominations or items of business for consideration at a shareholder meeting (other than proposals submitted under SEC Rule 14a-8) to provide specified information about themselves, certain related parties, the director nominees and the business proposals within a specified time period prior to a shareholder meeting. By requiring this information in advance of the shareholder meeting, these bylaws support transparency, informed board consideration, orderly shareholder meetings and informed shareholder voting.

Increased Activism

Since January 2022, activists have initiated over 900 public campaigns at corporations traded in the U.S.[67] During the first three quarters of 2024, global activist campaign activity has risen 26% compared to the historical four-year average.[68]

Considerations

Given the heightened levels of activism and as a matter of good corporate housekeeping, companies should revisit their advance notice bylaw provisions from time to time. Companies choosing to revisit their advance notice bylaw provisions should be mindful of the timing and circumstances surrounding any modifications to their existing provisions.

Specifically, the recent decision by the Delaware Supreme Court in *Kellner v. AIM ImmunoTech, Inc*. should serve as a guide for companies considering changes to their advance notice bylaw provisions. The Delaware Supreme Court explained that bylaws must be "twice tested" for assessment of both their facial validity and whether they are applied equitably.[69] Facial validity depends on whether the bylaw provision is contrary to law or the company's certificate of incorporation and addresses a proper subject matter. The court found most of the provisions in question to be facially valid, other than one that the court described as "nonsensical" and requiring sweeping disclosure.

The second inquiry assessed whether the board faced a threat to an important corporate interest and acted with proper, unselfish and loyal motivations, and then assessed whether the board's response was reasonable in relation to the threat and not preclusive or coercive to the shareholder franchise. Finding that the amended advance notice provisions were not adopted on a "clear day," the court held that the provisions were designed to thwart an approaching proxy contest and remove any possibility of a contested election, resulting in all of the challenged bylaw provisions being inequitable and unenforceable.

Accordingly, companies should work with their legal advisors to occasionally revisit their advance notice provisions rather than wait until a contested election appears likely.

Emerging Shareholder Proponent Tactic

During the 2024 proxy season, a labor union decided to file its own proxy statement and solicit proxies under Rule 14a-4 rather than seeking to include shareholder proposals in the company's proxy statement in reliance on Rule 14a-8. The union's proxy materials included five shareholder proposals submitted in accordance with the company's advance notice bylaws, but notably, the union did not seek to elect its own slate of directors. This process allowed them to put multiple proposals on the ballot and evade the "one proposal per proponent" limit under Rule 14a-8.

The proponent's strategy: Following the adoption by the SEC of rules requiring the use of universal proxy cards, companies and shareholders in contested board elections must include all director nominees presented by management and shareholders on their own proxy cards. If a shareholder proponent is not actually nominating director candidates as part of its campaign, the proponent may choose to include the company's director candidates on its proxy card along with the proponent's proposals. The inclusion of the company's entire director slate by a proponent increases the likelihood of shareholders returning the proponent's proxy card (since shareholders can vote for directors on either card even if the proponent is not nominating any director candidates). If enough shareholders return the proponent's proxy card, the company may not be able to assess whether it has a quorum or track voting results in an effective manner. By soliciting proxies itself, the proponent will gain information about the percentage of shareholders voting, and may be able to pressure companies into including the proponent's proposals in the company's own proxy materials.

While it is unclear if additional shareholder proponents will utilize this strategy, companies should remain diligent in monitoring their advance notice bylaw deadlines for proposals that might typically have been submitted under Rule 14a-8.

Consider Enhancing Voluntary Proxy Disclosures

Annual meeting proxy statements have transformed from a compliance document to a strategic shareholder engagement and marketing tool. More than ever, companies are using their annual meeting proxy statements as an opportunity to provide investors

[67] See publicly available data from DealPoint Data. Excludes activism activity at closed-end funds and Rule 14a-8 proposals.

[68] See Barclays, "Q3 2024 Review of Shareholder Activism" (Nov. 11, 2024).

[69] See *Kellner v. AIM ImmunoTech, Inc.* 307 A.3d 998 (Del. Ch. 2023).

with additional insight on the company and its board of directors. In light of this trend, companies should consider enhancing their proxy statements by providing voluntary disclosures covering the following areas of investor focus.

Shareholder Engagement

Companies should consider highlighting shareholder outreach initiatives, demonstrating both how the company proactively sought and responded to shareholder feedback. In particular, this disclosure should describe:

- The number of shareholders engaged and the percent of outstanding common stock represented by such shareholders.
- Feedback from shareholders, including common topics of interest.
- Actions taken in response to the feedback.

Board Skills Matrix

In connection with each election of directors, it is critical that companies demonstrate to shareholders how the skill sets and experiences of each director, both individually and together, align with the company's business and strategic needs. A growing number of companies are disclosing a board skills matrix to convey this message. Board skills matrices should be specifically tailored to the company and accompanied by narrative disclosure explaining why each highlighted skill is meaningful to oversight of the company. Also, in the event there is a gap for a particular skill, the company should describe how the board bridges the gap, such as by leveraging outside advisers.

Board Self-Evaluations

In addition to ensuring the board is comprised of directors with the appropriate skills, the board should also have mechanisms to facilitate ongoing improvement. The self-evaluation process is one key to the board's continued development. Companies should consider enhancing their proxy statements by describing the board's self-evaluation process, including:

- Evaluation processes undertaken at the board, committee and individual levels, including the committee/individual responsible for oversight of the process.
- Results of the most recent self-evaluations.
- Actions taken in response to such results.

ESG

Notwithstanding certain anti-ESG sentiments, ESG matters remain a focal point for many investors, proxy advisory firms and other stakeholders. Expectations for ESG disclosures continue, particularly for disclosures regarding (i) board oversight of ESG risks and (ii) the company's approach, aspirational goals and measurable progress relating to climate change, human capital management, sustainability and other significant ESG matters.

Although the SEC's rules currently do not mandate specific ESG disclosure in proxy statements, the accuracy and completeness of companies' voluntary ESG disclosures are subject to scrutiny by the SEC and others. Also, many companies incorporate ESG metrics into executive compensation, which could draw additional investor attention to those metrics and related proxy statement disclosures.

Given investor expectations and regulatory focus on ESG disclosures, companies should consider the following actions when enhancing ESG disclosures in their annual proxy statements:

- Confirm support for disclosures and consistency with any related company disclosures in, for example, other SEC filings, corporate websites, marketing materials, investor presentations and stand-alone ESG reports.
- Clarify parameters where appropriate, including, for example, how ESG targets and data are measured (*e.g.*, GHG emissions) and any assumptions or risks that could materially impact the implementation of ESG initiatives or expected timelines.
- Include appropriate cautionary language on forward-looking statements, particularly because ESG disclosures typically involve future plans and estimates that are subject to uncertainties.

SEC Reporting and Compliance and Corporate Governance Contacts

Brian V. Breheny
Partner / Washington, D.C.
202.371.7180
brian.breheny@skadden.com

Raquel Fox
Partner / Washington, D.C.
202.371.7050
raquel.fox@skadden.com

Marc S. Gerber
Partner / Washington, D.C.
202.371.7233
marc.gerber@skadden.com

Andrew J. Brady
Of Counsel / Washington, D.C.
202.371.7513
andrew.brady@skadden.com

Caroline S. Kim
Counsel / Washington, D.C.
202.371.7555
caroline.kim@skadden.com

Leo W. Chomiak
Associate / Washington, D.C.
202.371.7511
leon.chomiak@skadden.com

Jeongu Gim
Associate / Washington, D.C.
202.371.7223
jeongu.gim@skadden.com

Nicholas D. Lamparski
Associate / Washington, D.C.
202.371.7323
nicholas.lamparski@skadden.com

Khadija L. Messina
Associate / Chicago
312.407.0116
khadija.lalani@skadden.com

Joshua Shainess
Associate / Washington, D.C.
202.371.7594
joshua.shainess@skadden.com

Sydney E. Smith
Law Clerk / Washington, D.C.
202.371.7333
sydney.smith@skadden.com

Kyle Wiley
Associate / Washington, D.C.
202.371.7351
kyle.wiley@skadden.com

Executive Compensation and Benefits Contacts

Page W. Griffin
Partner / Palo Alto
650.470.4560
page.griffin@skadden.com

Shalom D. Huber
Partner / New York
212.735.2483
shalom.huber@skadden.com

Joseph M. Penko
Partner / New York
212.735.2618
joseph.penko@skadden.com

Erica Schohn
Partner / New York
212.735.2823
erica.schohn@skadden.com

Michael A. Wiseman
Partner / New York
212.735.2662
michael.wiseman@skadden.com

Joseph M. Yaffe
Partner / Palo Alto
650.470.4650
joseph.yaffe@skadden.com

Kristin M. Davis
Counsel / Palo Alto
650.470.4568
kristin.davis@skadden.com

Cassie M. Ashley
Associate / Palo Alto
650.470.4656
cassie.ashley@skadden.com

Allison Rosensteel
Associate / Palo Alto
650.470.3148
allison.rosensteel@skadden.com

This communication is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This communication is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

skadden.com