Client Alert | US Public Company Advisory / Capital Markets

Key Considerations for the 2021 Annual Reporting and Proxy Season

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This memorandum outlines key considerations from White & Case's Public Company Advisory Practice for US public companies in preparation for the 2021 annual reporting and proxy season.

Section I of this memo, which was previously published, described our key considerations for Annual Reports on Form 10-Ks, including housekeeping items and our top nine disclosure considerations for Form 10-Ks in 2021.

Section II of this memo, below, describes our top considerations for 2021 Annual Meeting Proxy Statements.

Section II: Top Seven Considerations for 2021 Annual Meeting Proxy Statements

The following are our top considerations for your upcoming annual meeting proxy statement.

1. **Consider Impacts of COVID-19 for Proxy Disclosure.** In assessing your proxy disclosure, companies should take into account the impacts of the COVID-19 pandemic and related economic conditions in the following areas of their proxy statement:

   - ***Letter to Shareholders; Proxy Statement Summaries.*** Consider your messaging around the COVID-19 pandemic to investors in the beginning of your 2021 proxy statement, including in letters to shareholders and proxy statement summaries, and consider referencing the company's priorities in light of the pandemic.

   - ***Compensation Disclosure & Analysis ("CD&A").*** In CD&As, to the extent compensation decisions were taken in response to the pandemic, companies should explain the key impacts of the pandemic on such executive compensation decisions. In particular, ISS issued guidance in October 2020 stating that it may view COVID-19 related changes to bonus/annual incentive programs and COVID-19 related retention or other one-time awards as a "reasonable response" to the pandemic so long as the "justifications and rationale are clearly disclosed, and the resulting outcomes appear reasonable." For example, ISS provided a non-exclusive list of disclosure items expected to be covered when discussing changes to annual incentives, including specific challenges resulting from the pandemic that rendered the original performance targets obsolete or impossible to achieve, the rationale for the company's chosen approach, and how the resulting payouts reflect both executive and company performance. Companies should be particularly prepared to explain above-target payouts under changed programs, which ISS has indicated will be closely scrutinized.

     In addition to discussing 2020 compensation, companies may consider discussing 2021 compensation decisions in order to help place 2020 decisions into context for investors. Such

decisions that "could affect a fair understanding of the named executive officer's compensation for the last fiscal year"[1] should be addressed, and ISS noted in its October guidance that companies are encouraged to disclose positive changes to their annual incentive program for 2021, which may mitigate ISS' qualitative evaluation of disclosure for fiscal 2020 compensation.

- ***Tabular Compensation Tables.*** Like with the CD&A, tabular compensation tables should be reviewed in light of a company's 2020 compensation decisions, including changes resulting from the COVID-19 pandemic. For example, if prior equity awards were modified during 2020, a company will need to disclose the incremental fair value computed as of the repricing or modification date.[2] With respect to cash awards earned for 2020 service, companies should confirm whether the cash amounts earned were (1) based on the satisfaction of a pre-established performance target, in which case such amounts should be reported in the non-equity incentive plan compensation column of the Summary Compensation Table, or (2) based on the discretion of the board or compensation committee, in which case such amounts should be reported in the bonus column of the Summary Compensation Table.

2. **Update Your Pay Ratio Disclosure.** The 2021 proxy season will be the fourth year for mandatory pay ratio disclosure.[3] The pay ratio rule permits a company to identify its median employee once every three years; therefore, companies that have been using the same median employee since pay ratio disclosures were first required for fiscal 2017 must identify a new median employee for fiscal 2020. This year, companies should also assess whether they need to select a new median employee due to significant changes in their employee population or compensation arrangements as a result of COVID-19 impacts.[4] Use of the same median employee for three years is permissible as long as the company reasonably believes there has not been a change in its employee population or compensation arrangements that would significantly affect its pay ratio disclosure. Accordingly, companies should confirm whether they are required to re-identify their median employee as a result of changes in their employee populations or employee compensation arrangements, including changes resulting from the COVID-19 pandemic.

3. **Scrutinize Perquisites in Light of Recent SEC Guidance.** The SEC issued guidance in September 2020 (see C&DI 219.05) emphasizing that during the pandemic the same two-step analysis continues to apply when determining whether an item is a perquisite (i.e., "an item is not a perquisite…if it is integrally and directly related to the performance of the executive's duties"; "otherwise, an item that confers a direct or indirect benefit and that has a personal aspect, without regard to whether it may be provided for some business reason…is a perquisite or personal benefit unless it is generally available on a non-discriminatory basis to all employees"). Whether an item is "integrally and directly related" to the performance of the executive's duties depends on whether an executive needs the perquisite to do the job, but the SEC also indicated in its recent C&DI that the outcome of this analysis depends on the particular facts and can change over time:

   "In some cases, an item considered a perquisite or personal benefit when provided in the past may not be considered as such when provided as a result of COVID-19. For example, enhanced technology needed to make the NEO's home his or her primary workplace upon imposition of local stay-at-home orders would generally not be a perquisite or personal benefit because of the integral and direct relationship to the performance of the executive's duties."

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[1] *See* Instruction 2 to Item 402(b) of Regulation S-K.

[2] *See* Instruction 2 to Item 402(c)(2)(v) and (vi) of Regulation S-K.

[3] Pay ratio disclosure is not required for EGCs or SRCs.

[4] The analysis of whether a new determination of the median employee is required is a company-specific matter. For example, in some situations, a significant acquisition or divestiture may affect workforce composition or compensation arrangements. In other situations, changes in a company's employee population that have cumulated over two years may require a company to identify a new median employee for the third year of pay ratio disclosure. For more information, *see* our prior alerts, "SEC Adopts Final Rules on CEO Pay Ratio Disclosure" and "The SEC's New Guidance Provides Additional Flexibility for Compliance With CEO Pay Ratio Disclosure."

In its 2020 annual report the SEC's Division of Enforcement confirmed that the SEC is scrutinizing perquisite disclosure, using "risk-based data analytics to uncover potential violations," which led to a settled enforcement action against one company for failing to fully disclose perquisites and personal benefits to executive officers. Companies should therefore carefully analyze the benefits provided to executives over the past year and evaluate each item using the two-factor SEC test.

4. **Consider Board Related Disclosures: Diversity, Skills, Biographies & Risk Oversight.** Board-related disclosures continue to be a focus for investors and companies should assess their board related disclosures as follows:

- ***Board Risk Oversight.*** A key section for board-related disclosures is the board risk oversight section. Item 407(h) of Regulation S-K requires companies to disclose the board's role in the risk oversight of a company, such as how the board administers its oversight function. The SEC has emphasized that companies should also discuss how their boards oversee the management of material risks, such as with respect to cybersecurity risks. Moreover, investors have increasingly scrutinized this disclosure for descriptions of the board's oversight over ESG issues.[5]

  In addition, beginning in 2021, Glass Lewis will note as a concern when boards of companies in the S&P 500 index do not provide clear disclosure concerning the board-level oversight afforded to environmental and/or social issues, and ISS has added "demonstrably poor risk oversight of environmental and social issues, including climate change" to the list of material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company that will result in a recommendation of a vote against or a withhold from directors, committee members, or the entire board.

- ***Diversity.*** The SEC's longstanding rule on board diversity requires companies to disclose whether, and if so how, the nominating committee or the board considers diversity in identifying nominating nominees for director. Furthermore, the SEC's 2019 guidance (see C&DI 116.111) on board diversity also remains an important consideration for a company's board diversity disclosure.

  The call for enhanced disclosure on board diversity has only accelerated in recent months. For example, starting in February 2021, ISS will recommend against the chair of the nominating committee, and other directors as appropriate, at companies with no women on their board, and ISS reports will highlight boards that lack racial and ethnic diversity (or lack disclosure of such). See **Appendix A** for a full description of board diversity policies of investors. If a company decides to enhance its board diversity disclosure for this year's proxy statement, it should confirm that each director has consented to the company's disclosure of those diversity characteristics via a D&O or other questionnaire.

- ***Skills Matrix.*** In light of market trends towards companies providing increased director qualification disclosure as a result of investor pressure on this subject, companies may want to consider enhancing their board composition disclosures by providing a matrix summarizing the skills of their directors. In drafting this disclosure, companies should consider whether to disclose each individual director's skills or aggregated data, and which skills to include in the matrix (for example, common skills included financial/accounting, industry knowledge, compensation/HR, board/governance experience and legal/regulatory/compliance experience). Glass Lewis has described a board skills matrix as an "emerging best practice" for corporate disclosure and, beginning in 2021, reports for companies in the S&P 500 index will include an assessment of company disclosure in the proxy statement relating to board diversity, skills and the director nomination process. While Glass Lewis will not be making voting recommendations solely on this basis in 2021, it will inform its assessment

[5] Institutional investors are also focused on the board's role in risk oversight, particularly of ESG issues. For example, at National Fuel Gas Company's annual meeting, BlackRock reported voting against the re-election of the company's audit committee chair due to "the company's lagging disclosure related to the oversight and management of climate-related risks and the materiality of the risk to the company." *See* BlackRock's press release, available here.

of a company's overall governance and may be a contributing factor in recommendations when additional board-related concerns have been identified.[6]

- ***Director Biographies.*** In addition to a director's business experience during the past five years, the biographical information for directors in proxy statements must include information on outside board service, as further described below.

  Given the increasingly strict overboarding policies of institutional investors, it is crucial to monitor the number of outside directorships your company's directors hold. During the 2020 proxy season, opposition to directors increased to its highest level since 2011, due in part to new or stricter overboarding policies of some institutional investors, and Glass Lewis cited overboarding as one of the top reasons it recommended against a director.[7] Two key tips on this:

  - ***First, Know Your Key Investors' Policies.*** A company should be aware of its investors' policies with respect to overboarding and educate its board of directors on these policies. See **Appendix B** for an outline of these policies.

  - ***Second, Carefully Draft Your Director Biographies in the Proxy Statement.*** In proxy statements, information on outside directorships is provided in the directors' biographical section pursuant to Item 401(e)(2) of Regulation S-K. Based on this disclosure, investors can find information on the number of outside directorships held by a company's directors. One key point on this outside directorship disclosure is that, to the extent a director at your company is serving on an outside *private* company's board of directors, there is no SEC requirement to disclose this information.[8] Moreover, if a private company directorship is voluntarily disclosed, your proxy statement should clarify that the outside directorship is at a private company in order to avoid having that directorship inadvertently counted against the director under an overboarding policy. A second key point is to consider disclosing any extenuating or additional circumstances for overboarding situations. For some investors, this additional explanation may be helpful if a director is overboarded. For example, Vanguard's policy states that a fund might vote for an overboarded director if the director has publicly committed to stepping down from a directorship in order to fall within the thresholds.[9]

5. **Assess ESG Disclosure in Proxy Statement.** With a growing number of institutional investors now demanding ESG information, these disclosures have increasingly become mandatory by default for many public companies, as explained by acting director of the SEC's Division of Corporation Finance John Coates.[10] In addition, as described in the White & Case Public Company Advisory Group survey of ESG information in SEC filings, the proxy statement has increasingly become the home for much of the increase in ESG disclosure in SEC filings. Companies should weigh the appropriateness and benefits of enhancing their ESG disclosures in proxy statements and consider their own facts and circumstances in determining the appropriate level of ESG disclosure in their proxy statements.[11] As noted in our recent client alert, sustainability disclosure on corporate websites can provide equally effective vehicles for this

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[6] The skills matrix first came to the fore in 2017, when New York City Comptroller Scott Stringer, on behalf of the New York City Pension Fund, sent letters to 151 companies calling for the disclosure of a matrix covering the key skills, experience and attributes of board members.

[7] For example, at Bristol-Myers Squibb Co.'s May 2020 annual meeting, Neuberger Berman disclosed voting against an incumbent director due to overboarding concerns. *See* here.

[8] *See* Item 401(e)(2) of Regulation S-K, which only requires a company to disclose current outside directorships (and those held in the past five years) of a company's directors at public companies (*i.e.*, those with securities registered under section 12 or subject to the requirements of section 15(d) of the Exchange Act) and registered investment companies.

[9] *See* Vanguard policy on "Overboarded Directors" available on page four here.

[10] *See* here.

[11] Companies should note the enhanced liability implications of including disclosure in their proxy statements. In addition to Section 10(b) and Rule 10b-5, which are applicable to all public disclosures, Rule 14a-9 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Section 18 of the Exchange Act impose heightened liability risks for false and misleading statements filed with the SEC in proxy statements and annual reports, respectively.

disclosure to investors. Regardless of the ultimate approach taken, the ESG information that is disclosed in proxy statements should be vetted, reviewed by all appropriate parties and checked for consistency with information disclosed elsewhere by a company, including the recent human capital disclosures in Form 10-Ks and voluntary sustainability reports on corporate websites.

6. **Confirm Your Form Check and Housekeeping Items:** As companies focus on drafting their proxy statements, they should keep in mind a number of form check and housekeeping items, including, but not limited to, the following:

   - ***Section 16 Delinquencies.*** Companies should review their prior Section 16 reports and identify any reports that were not filed on a timely basis. For each such late report, a company will need to disclose the Section 16 insider who filed late, the number of late reports and transactions that were not reported on a timely basis, and any known failure to file a form.

   - ***Hedging Disclosures.*** This is the second year for this required disclosure and companies should assess their hedging policies and disclosure. Specifically, Item 407(i) of Regulation S-K requires that a company describe any practices or policies it has adopted regarding the ability of its employees, officers or directors to purchase financial instruments or to engage in transactions that hedge or offset, or are designed to hedge or offset, any decrease in the market value of equity securities held directly or indirectly by, the employee or director. It is important to review existing hedging policies and practices, and confirm that proxy disclosure is drafted to align with the company's current policies.

   - ***Confirm Sufficient Shares Available for Grants under Equity Compensation Plans*:** Confirm as early as possible that no additional shares are required for future grants under an equity compensation plan. A company should confirm both the number of existing shares still available for grant, as well as its plans for future equity grants. Adding shares to a plan can be a straightforward exercise when planned in advance, but it also involves many to-do items (including, for example, updating the equity compensation plan itself; carefully form-checking the equity plan proposal, which has been a hot-bed target for litigants; considering ISS and Glass Lewis policies to determine whether they will support the proposal and drafting disclosure to obtain their support; and finally, drafting a Form S-8 and supplemental listing application to list the additional shares).

7. **Plan for a Virtual or Hybrid Shareholder Meeting.** Last but not least, confirm your annual meeting format for 2021. As a result of the pandemic, virtual meetings increased nearly 700% in 2020 when compared with 2019, and the high rate of virtual-only meetings is expected to continue in 2021. Companies opting to hold virtual-only meetings should consider their disclosure in light of proxy advisory firm policies. In particular, Glass Lewis issued a policy that it expects "robust disclosure" in the proxy statement addressing the ability of shareholders to participate in the meeting, including disclosure of shareholders' ability to ask questions at the meeting; procedures, if any for posting appropriate questions received during the meeting and the company's answers on its public website; and logistical details for meeting access and technical support.[12] Where such disclosure is not provided, Glass Lewis will generally recommend against the chair of the governance committee.[13]

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[12] For more information, see our alert "Glass Lewis Guidelines Update Policy on Virtual-Only Meetings Due to COVID-19."

[13] ISS released guidance that boards are "encouraged to commit to return to in-person or "hybrid" meetings (or to put that matter to shareholders to decide) as soon as practicable." *See* here.

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Appendix A
Board Diversity Policies and Initiatives

Gender Diversity Policies of Proxy Advisory Firms:

- **ISS:** Beginning February 2021, ISS will recommend against the chair of the nominating committee, and other directors as appropriate, at companies with no women on the board. The only exception is if the board has temporarily lost its gender diversity and makes a firm commitment to return to a gender-diverse status within a year.
- **Glass Lewis:** Beginning in 2021, Glass Lewis will now "note as a concern" boards with fewer than two female directors, but will make voting recommendations based on the current requirement of at least one female board member. Starting January 1, 2022, it will generally recommend against the nominating chair if the board has fewer than two female directors.

Racial/Ethnic Diversity Policies and Initiatives:

- **ISS:** For 2021, ISS reports for Russell 3000 or S&P 1500 companies will highlight boards that lack racial and ethnic diversity (or lack disclosure of such), but will not use any lack of racial and/or ethnic diversity as a factor in its vote recommendations on directors. For 2022, if a company in the Russell 3000 or S&P 1500 has no apparent racially or ethnically diverse board members, ISS will generally recommend voting against or withhold from the chair of the nominating committee (or other directors on a case-by-case basis). An exception will be made if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the board makes a firm commitment to appoint at least one racially and/or ethnically diverse member within a year.
- **BlackRock:** Expects companies to provide board diversity disclosures (including data with respect to race and ethnicity) and has requested disclosures that "fully reflect [a company's] long-term plans to improve diversity, equity, and inclusion, as appropriate by region" "with an eye toward more voting action against boards not exhibiting diversity in 2022." *See* BlackRock's letter to CEO's, available here.
- **State Street:** Starting in 2021, expects companies in its investment portfolio to disclose: (i) the role diversity plays in the company's broader human capital management practices and long-term strategy; (ii) a description of the company's diversity goals, how these contribute to the overall strategy, and how they are managed and progressing; (iii) measures of diversity among the company's global employee base and board, including the racial and ethnic makeup of the board; (iv) its goals and strategy related to racial and ethnic representation on the board, including how the board reflects the diversity of the company's workforce, customers and other key stakeholders; and (v) a description of how the board executes its diversity and inclusion oversight role.
- **Russell 3000 Board Diversity Disclosure Initiative**: A 22-member investor coalition representing over $3 trillion in assets under management encouraging companies to include data on their board's racial and ethnic composition in their 2021 proxy statements. Each member either has or is considering policies to vote against nominating committees who fail to disclose such data in their proxy statements.
- **NYC Comptroller's Boardroom Accountability Project 3.0**: The NYC Comptroller's office sent letters to 56 S&P 500 companies requesting they adopt a diversity search policy requiring the initial list of management-supported director nominees and CEO candidates to include qualified female and racially/ethnically diverse candidates from non-traditional fields (ex. government, academia and not-for-profit sector). The Comptroller's Office negotiated board and CEO diversity search policies with 13 leading companies.
- **Nasdaq Diversity Disclosure Proposal**: Nasdaq has proposed new listing rules that would require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+. In addition, if approved, the new listing rules would require all Nasdaq-listed companies to publicly

disclose “consistent, transparent diversity statistics regarding their board of directors” using a standardized disclosure matrix template either in their annual meeting proxy statements or on their websites.[14]

Examples of State Laws regarding Board Diversity:

- **California:** In September 2020, California adopted legislation requiring any public company with principal executive offices (“PEO”) in California to have a minimum of one director from an “underrepresented community” who self-identifies as a racial or ethnic minority or as LGBTQ by December 31, 2021. No later than December 31, 2022, (i) a corporation with more than four but fewer than nine directors will be required to have a minimum of two directors from underrepresented communities, and (ii) a corporation with nine or more directors will need to have a minimum of three directors from underrepresented communities. In addition, in 2018 California adopted a law requiring any public company with a PEO in California to have at least one female director by December 31, 2019. By December 31, 2021, at least two female directors must sit on any board with five directors, and at least three female directors must sit on any board with six or more directors.
- **New York:** Requires companies “authorized to do business” in New York to disclose the number of women on their boards.
- **Illinois:** Requires any public company with principal executive offices in Illinois to disclose the number of directors who identify as women or racial or ethnically diverse.

[14] For more information, see our prior alert, “Nasdaq Proposes New Board Diversity Listing Requirements.”

Appendix B
Director Overboarding Policies

- ***ISS:*** Generally recommend against/withhold from directors who (i) sit on more than **five** boards; or (ii) are CEOs of public companies who sit on the boards of more than **two** *other* companies (total of **three**, withhold only at their outside boards).[15]
- ***Glass Lewis:*** Generally recommend against (i) a director who serves as an executive officer of any public company while serving on more than **two** public company boards; and **(ii)** any other director who serves on more than **five** boards.[16]
- ***BlackRock:*** CEO can sit on one outside board (total of **two**); other directors can sit on three outside boards (total of **four**).
- ***Vanguard:*** A named executive officer can sit on **one** outside board (total of **two**); other directors can sit on four boards.[17]
- ***State Street*:** CEO can sit on **two** boards; board chairs or lead independent directors can sit on **three** boards; other directors can sit on **four** boards.
- ***CalPERS*:** A named executive officer can sit on **one** outside board (**two** total); other directors can sit on **four** boards.
- ***NYC Comptroller:*** CEO can sit on **two** outside boards (**three** total, vote against only at outside boards); other directors can sit on **four** boards.

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[15] ISS will also generally vote against the bundled election of directors if one or more nominees, if elected, would be overboarded.

[16] Glass Lewis may consider relevant factors such as: (i) the size and location of the other companies where the director serves on the board, (ii) the director's board roles at the companies in question, (iii) whether the director serves on the board of any large privately-held companies, (iv) the director's tenure on the boards in question, and (v) the director's attendance record at all companies. For directors who serve in executive roles other than CEO (e.g., executive chair), it will evaluate the specific duties and responsibilities of that role in determining whether an exception is warranted. Glass Lewis may also refrain from recommending against certain directors if the company provides sufficient rationale for their continued board service. The rationale should allow shareholders to evaluate the scope of the directors' other commitments, as well as their contributions to the board including specialized knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide, and other relevant factors.

[17] In certain instances, Vanguard will consider voting for a director who would otherwise be considered overboarded because of company-specific facts and circumstances that indicate the director will have sufficient capacity to fulfill his/her responsibilities or if the director has publicly committed to stepping down from the other directorship(s) as necessary to fall within the listed thresholds.