SHEARMAN & STERLING

2021 Proxy Season Quick Reference Guide

The 2021 proxy season is just around the corner. This quick reference guide, which is intended to supplement Shearman & Sterling's *18th Annual Corporate Governance & Compensation Survey*, summarizes themes from the 2020 proxy season and developing trends to consider for 2021. It also identifies possible future changes in disclosure rules that U.S. public companies should consider for the upcoming proxy season.

HUMAN CAPITAL MANAGEMENT

Increased focus on enterprise-wide human capital management, and the perspective that workforce considerations can be material to shareholders, have also influenced a separate but related change in corporate governance: disclosures regarding policies, practices and initiatives related human capital management.

Fueling the change will be the adoption by the SEC of new human capital management disclosure rules, which became effective November 9, 2020. These principle-based rules are a response to the perspective that human capital is a critical source of value for most companies, which demands that companies speak to investors about it. The new rules require, to the extent material, a description of the issuer's human capital resources, including any human capital measures or objectives that management focuses on in managing the business (such as measures that address attraction, development, and retention of personnel).

Although the new SEC disclosure rules are required only in the Form 10-K and registration statements, we continue to expect companies to include human capital disclosures in the proxy statement, as the proxy statement has become an increasingly important vehicle for a company to present an overview of its approach to key ESG issues as part of its stakeholder engagement efforts.

COVID-19–RELATED COMPENSATION CHANGES

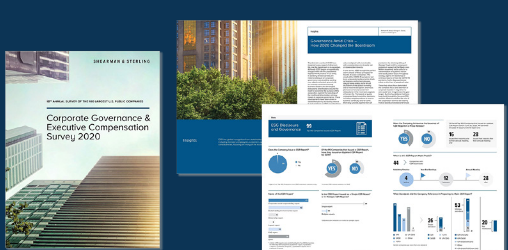
The impact of COVID-19 on the global economy has forced many companies to reevaluate their incentive compensation programs. Although mid-year changes to performance metrics are typically frowned upon by institutional investors and proxy advisory firms, companies may find a more understanding audience this year, provided they adequately "tell the story" behind the compensation changes and the compensation-related changes are due to COVID-19 considerations.

In discussing any changes related to COVID-19, the CD&A should describe the challenges faced by the business, how changes to the compensation program are tied to those challenges, how the changes benefit investors and how the payouts compare with what would have been paid under the original program. Include any peer group analysis that the Board or compensation committee considered.

Finally, to the extent 2021 program design is impacted by COVID-19 and perhaps differs from 2020 plan design, this should also be described and may serve to mitigate concerns over the 2020 changes. ISS has also issued FAQs on how it will examine COVID-19-related decisions as part of its pay-for-performance analysis.

BOARD OF DIRECTOR ASSESSMENTS

We anticipate that the board evaluation process will continue to receive focus in the 2021 proxy season. The board evaluation process has garnered increased attention from institutional investors, as it is increasingly becoming integrated into board refreshment discussions. Institutional investors are looking at the details of how a board evaluates its performance beyond the practice of self- assessment questionnaires and surveys. Proxy advisory firms have also shown interest in the board evaluation process. According to its 2020 ESG Governance Quality Scorecard, ISS expects boards, committees and individual directors to regularly assess their effectiveness and contribution. The evaluation process should include individual director assessments and involve a third party at least every three years. Glass Lewis also has an expectation of routine director evaluations, which include third-party reviews. Accordingly, many companies are turning to an outside party to engage in a process of director interviews, the results of which are shared with the Board. As you evaluate whether the Board self-assessment process should be refreshed this year, keep in mind what will be said in the 2021 proxy statement and, if you embark on a third party interview process, how that process will run to balance transparency and confidentiality.



Shearman & Sterling's *18th Annual Corporate Governance & Executive Compensation Survey*

Please also see our *18th Annual Corporate Governance & Executive Compensation Survey*, where we review the major themes from the 2020 proxy season and analyze the associated data to provide detailed insights for the coming proxy season.

SHAREHOLDER PROPOSALS

We anticipate there will be an uptick in shareholder engagement and proposals in the following areas in the 2021 proxy season: diversity, social justice and human capital management. In responding to shareholder proposals, companies should always consider whether they can make a credible argument for exclusion, but, more so than in the past, companies should consider the message that could be drawn from a no-action letter that seeks to exclude a shareholder proposal. No-action letters seeking to exclude shareholder proposals are premised on nuanced understanding of, and appreciation for, the "SEC precedent" that has developed around concepts like "significant policy issue" and "substantially implemented."

A public letter from a company that asserts that a particular social policy initiative raised by a shareholder proposal is not a policy issue for the company or has been fully addressed by the company, could be easily misconstrued or, worse, used to paint the board or management as out of touch. Companies should seriously consider meaningful engagement with proponents before seeking the SEC's concurrence with exclusion of a proposal from the proxy statement. If a company decides to exclude a shareholder proposal, it should keep in mind that the audience for the no-action letter is broader than it ever has been.

Companies should also be mindful of changes coming in the 2022 proxy season to the shareholder proposal rules. In September 2020, the SEC adopted amendments to certain eligibility requirements for shareholder proposals that include raising the ownership threshold for submission eligibility and the resubmission threshold with respect to a proposal if it deals with substantively the same subject matter as another proposal submitted in the previous five years. These amendments are the first substantive changes to the shareholder proposal rules since 1998. Increased emphasis on engagement puts more importance on identifying directors with that skillset. From a disclosure perspective, we note that companies are increasingly providing more details about shareholder engagement efforts in their proxy statement summaries.

DIVERSITY

Investors, legislators and advocates have become increasingly focused on the diversity of corporate boards. For example, California and Washington have implemented diversity mandates requiring that at least a certain number of directors in a public company board identify as women, and Illinois, Maryland and New York have laws that impose board diversity reporting requirements.

On December 1, 2020, Nasdaq filed with the SEC a proposal to adopt listing rules related to board diversity. The proposed diverse board representation rule would require each Nasdaq-listed company to have (subject to certain exceptions), or explain why it does not have, at least two "diverse" directors, including (1) at least one director who self-identifies as "female," and (2) at least one director who self-identifies as an "Underrepresented Minority" or "LGBTQ+." Nasdaq has published a summary and FAQs to help companies understand the proposed board diversity listing rules and has indicated that further resources and assistance will be made available.

Blackrock, Inc. has said it would expect to see at least two women directors on every board, and ISS has proposed a voting policy change for the 2022 proxy season to recommend a vote against or withheld from the nominating committee chair (or other directors in a case-by-case basis) where the board has no apparent racially or ethnically diverse members. For 2021, ISS intends only to highlight this gap.

We also expect that diversity beyond the boardroom will become of increasing importance to institutional investors and social policy advocates. We heard time and again, as the protests for social justice increased in 2020, that diversity in the executive ranks is as important and that efforts to build the pipeline should start in the more junior ranks. Consider disclosures about diversity metrics for the whole company and company-wide efforts that are being taken to address diversity.

VIRTUAL ANNUAL BOARD MEETINGS

Many companies successfully navigated the transition from in-person to virtual annual shareholder meetings this year due to the COVID-19 pandemic. This large-scale transition produced lessons learned and best practices to consider. Given the uncertainty related to the duration of the COVID-19-related social distancing protocols, many companies are expecting and planning to again hold annual meetings virtually again in 2021.

One theme to emerge is process transparency for shareholders. Be sure to provide thorough, thoughtful and jargon-free instructions in proxy materials describing what a shareholder needs to do to attend, vote and ask questions. Consider providing shareholder login information well in advance and providing a help-line number or online chat feature to guide shareholders on the day of the meeting and manage technical issues.

Not everyone was pleased with the 2020 virtual annual meeting season. Many complained that the virtual format contributed to shareholder disenfranchisement. The complaints centered on the inability of shareholders to engage directly with the board and management during the meeting, as most companies provided shareholders with the ability to submit questions by a message platform and not by voice. Companies are obviously concerned about allowing shareholders to ask questions in an open forum format, but companies can make efforts to improve engagement by adding a live video component to the meeting so that company shareholders can see management and the board, making it easier to submit questions in advance and publicizing all questions received and utilizing the video feature so that company shareholders can see management.

Companies should begin to work with their provider of their virtual meeting annual platform early as they create the structure for the annual meetings to facilitate making the virtual meeting features work seamlessly. Additionally, as we expect the use of the virtual annual meeting platform in 2021 to rival 2020, booking your meeting date early, with the limited number of experienced providers, is highly recommended.

Proposed Changes to Form S-8

In 2018, the SEC issued a Concept Release looking at ways to modernize Form S-8, the rules relating to the offer and sale of securities to employees under equity compensation plans (and Rule 701, the exemption relied upon by many private companies to compensate employees with stock). In November 2020, the SEC issued two proposed rules that resulted from the Concept Release. If finalized, these rules would address some of the issues that have been raised about the limitations on employee equity offerings that no longer match the reality of our workplaces, including the rise in "gig workers."

Proxy Drafting and Annual Meeting Housekeeping Checklist

- **Corporate Governance and Executive Compensation Highlights.** Consider how to craft an executive summary of the company's proxy, and potentially separately its CD&A, that is a visually appealing and compelling communication. Keep it specific for the biggest impact. Describe significant governance changes, diversity metrics on the board and in the executive ranks, significant compensation actions taken in 2020 and other ESG matters. Consider including a discussion of the impact on, and the company's response to, the COVID-19 pandemic and the calls for social justice and equality.

- **Coordinate Internally on Disclosure and Communication.** Coordinate across disciplines when preparing disclosure and communications about the Form 10-K, proxy statement, CSR reports and website disclosures related to governance and ESG matters. Message coordination may be critical in ensuring stakeholder engagement efforts are effective.

- **Equal Pay.** Ensure that pay practices and policies comply with state equal pay legislation and consider whether major shareholders want to better understand gender pay parity policies.

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

- **Committee Charters.** Conduct a review of the Compensation Committee Charter and Nominating and Governance Committee Charters to ensure that they appropriately allocate responsibility among the board committees for human capital matters and director compensation.

- **Institutional Investor and Proxy Advisory Firm Guidelines.** Review updates to the voting policies of applicable major investors, and ISS and Glass Lewis. ISS and Glass Lewis policy changes for the 2021 season have recently been released that should be considered when preparing for this proxy season.

- **Perquisite Disclosure.** Consider new COVID-19 guidance promulgated by the SEC, which includes an example of the perquisite analysis for benefits provided to executives in light of COVID-19. Inaccurate perquisite disclosure has resulted in SEC enforcement actions in recent years. The mere fact that a benefit is provided for a business reason is not sufficient to conclude that the benefit is not a perquisite.

- **Cybersecurity and Data Privacy.** Describe in the proxy statement which committee of the board has cybersecurity and data privacy risk management responsibility and how that risk is managed.

- **Hedging Policy Disclosure Rules.** Remember that the 2021 proxy season will be the second reporting period for which the hedging policy disclosures are required. Disclosure is required even for companies without hedging policies. The SEC may begin to take a closer look at disclosures in the second year after implementation.

- **Shareholder Engagement.** Consider how you are describing engagement efforts in the proxy statement. Companies are increasingly providing more details about shareholder engagement efforts in their proxy statement summaries – how many investors, who participated, topics covered and feedback received.

SPOTLIGHT

Succession Planning

- Identifying emergency successors or interim replacements and implementing a well-developed emergency succession plan is critical for companies to effectively mitigate risks related to unanticipated absences and departures of key executives and directors.
- Companies should examine their current processes to ensure that they can withstand current conditions.
- Consider whether talent and succession planning metrics should be incorporated as human capital-related performance metrics in incentive compensation plans.

For additonal insights on this topic, please read our recent publication, Succession Planning in a Time of Crisis.

Proxy Drafting and Annual Meeting Housekeeping Checklist (continued)

- **Equity Plan Adoptions or Amendments.** If adopting or amending an equity compensation plan, make sure that any disclosure complies with Item 10 of Schedule 14A and that the plan provides adequate limits on director compensation (including any cash compensation).
- **Clawback.** Identify whether the company currently has any form(s) of compensation clawback in place, what incentive programs they cover and whether employment agreements should be amended to incorporate clawback policies. Over the last decade, institutional investors and governance activists have increased focus on clawbacks. As a result, the prevalence of voluntary clawback policies, which act as a risk mitigator, has been on the rise.
- **Say-on-Pay Response.** Provide disclosure of your shareholder engagement efforts including, among other things, the frequency of engagement, as well as any specific concerns that had been raised. ISS expects a robust response to say-on-pay proposals that received less than 70% support. ISS will consider the relationship of the company's pay and disclosure changes to the feedback received.
- **Alternative Pay Disclosures.** Consider whether to include alternative pay disclosures—such as realized or realizable pay—being mindful that shareholders may ask questions to the extent these disclosures are omitted or modified in future years.
- **Non-GAAP Financial Measures.** To the extent included in the proxy, including the CD&A, other than with respect to performance target levels, disclosure requirements regarding the use of non-GAAP financial measures (explanation and reconciliation) must be met. Non-GAAP financial measures in the proxy statement have been a focus of SEC comments in recent years.
- **Compensation Committee Independence.** Review the compensation committee members' independence under NYSE and Nasdaq listing standards, ISS's affiliated outside director test and under Section 16 of the Securities Exchange Act.
- **HSR Thresholds.** Utilize proxy preparation time to check on compliance on other matters, like executive HSR thresholds (2021 thresholds are expected to be published in January 2021 and will take effect 30 days later).
- **D&O Questionnaires.** Ensure D&O questionnaires are up to date and consider including questions regarding board demographics.
- **Pay Ratio Local Impact.** Companies doing business in San Francisco, California should consider whether Proposition L, the newly approved tax applicable to the highest-paid managerial employees who earn more than 100 times the median employee compensation, would apply.

2021 CONSIDERATION

CEO Pay Ratio Disclosure

- Companies that have used the same median employee for the last three proxy seasons or have had significant changes to their employee population or compensation arrangements (whether due to COVID-19 or otherwise) must identify a new median employee for purposes of CEO pay ratio.
- Companies should formulate a strategy and gather necessary information early to evaluate the new employee population and determine a consistently applied compensation measure for identifying a new median employee.

For additonal insight on this topic, please read our recent publication, CEO Pay Ratio Disclosure.

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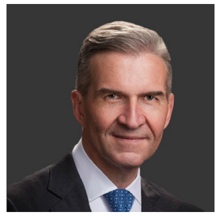

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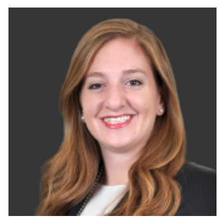

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