The U.S. Securities and Exchange Commission (SEC) issued rule updates and guidance in 2019 that are intended to simplify certain public reporting requirements, clarify the staff's expectations with respect to no-action relief for certain shareholder proposals and significantly revise the staff's process for responding to those no-action requests. In anticipation of the upcoming reporting season, we highlight rule changes, guidance and trends for public companies to consider in preparing annual report and proxy statement disclosures in 2020.

Shareholder Proposal, Proxy Statement and Annual Meeting Matters

Shareholder Proposals and No-Action Letter Process. *SLB 14K Guidance.* On October 16, 2019, the SEC's Division of Corporation Finance staff issued Staff Legal Bulletin No. 14K (SLB 14K), providing additional

guidance for companies submitting no-action requests to exclude shareholder proposals from proxy statements. In SLB 14K, the staff addressed the following:

- Clarified that whether a proposal relates to a "significant policy issue" in the context of the "ordinary business" exception under Rule 14a-8(i)(7) is a question of the significance of the issue to the particular company, rather than whether the issue is of universal significance
- Stressed the importance of board analyses provided in no-action requests to demonstrate that the policy issue raised by the proposal is not significant to the company
- Reminded companies that a no-action request concerning a proposal that the company's board believes is not significant is most helpful if it includes a detailed analysis substantiating the significance determination, which may include a delta analysis or results of prior shareholder votes
- Illustrated that a key inquiry in considering an argument for exclusion based on "micromanagement" is whether the proposal imposes a specific strategy, method, action, outcome or timeline, thereby supplanting the judgment of management and the board
- Advised companies to refrain from an overly technical reading of proof of ownership letters

For more information regarding SLB 14K, see our November 2019 update.

Shareholder Proposal No-Action Request Procedure Changes. In September 2019, the staff released a memorandum announcing two significant procedural changes to the Rule 14a-8 no-action letter process. Per the memorandum, the staff now may respond orally rather than in writing to some no-action requests where it does not believe that a written response would provide value. The staff intends to continue issuing written responses where it believes the response will provide more broadly applicable guidance about Rule 14a-8 compliance. In connection with this process change, the staff updated its process for posting responses to Rule 14a-8 no-action letter requests beginning on November 21, 2019. Responses, including verbal responses, are tracked in a chart available on the SEC website, which includes links to a PDF copy of the response letter when a written response is provided.

The second procedural change is that staff may now more frequently decline to state a view with respect to the company's asserted basis for exclusion. The staff noted that when it declines to take a view on a request, the company may still have a valid basis to exclude the proposal, and the parties may seek formal, binding adjudication on the merits in court. As discussed further below, Glass Lewis has announced that it will likely recommend against governance committee members for a company that excludes a shareholder proposal for which the staff declined to take a view.

Hedging Disclosure. In December 2018, the SEC adopted a new hedging policy disclosure rule to implement a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rule requires companies to disclose any practices or policies adopted regarding the ability of the company's employees, officers or directors to purchase any financial instruments or otherwise engage in transactions that hedge or offset, or are designed to hedge or offset, any decrease in the market value of company equity securities that the employees, officers or directors receive from the company as compensation or that they otherwise hold, directly or indirectly.

Companies have the option of satisfying the disclosure requirement by either (1) providing a fair and accurate summary of the practices or policies (both written and unwritten) or (2) disclosing the practices and policies in full. Any disclosure must include the categories of persons covered and the categories of hedging transactions that are specifically permitted or disallowed. If the company does not have any hedging policies or practices, it must disclose that fact and state, if accurate, that hedging transactions are generally permitted.

Most companies will be required to comply with the new rule in proxy statements for the election of directors during fiscal years beginning on or after July 1, 2019. Smaller reporting companies and emerging growth companies will be required to comply for director elections during fiscal years beginning on or after July 1,

2020. The disclosure is not required for foreign private issuers or listed closed-end investment companies.

Section 16 Delinquent Filing Disclosure. As part of the SEC's FAST Act Disclosure Simplification Amendments, and as described in our April 2019 update, the proxy statement disclosure heading required by Item 405(a)(1) has been amended from "Beneficial Ownership Reporting Compliance" to "Delinquent Section 16(a) Reports." The SEC encourages registrants to exclude the heading altogether if no disclosure is required. The revised rules also eliminate Rule 16a-3(e)'s requirement for reporting persons to furnish Section 16 reports to registrants and clarify that companies may rely on a review of Forms 3, 4 and 5 filed on EDGAR as well as any written representation from a reporting person that no Form 5 is required.

Perk Disclosure. The recent increase in SEC enforcement actions related to perquisite (or perk) disclosures underscores the importance of accurate reporting of perquisites in proxy statements.

The SEC's standard provides that unless an item is "integrally and directly related to the performance of the executive's duties," it must be disclosed as a perk if it confers a direct or indirect benefit on the executive that has a personal aspect, regardless of whether it has a business purpose, unless it is generally available to all employees on a non-discriminatory basis.

Companies should consider the following with respect to disclosure of perks in 2020 proxy statements:

- Ensure individuals tasked with preparing the Compensation Discussion and Analysis (CD&A) and the Summary Compensation Table are familiar with SEC's "integrally and directly related" standard for reporting perks
- Coordinate human resources, finance, legal and other functions and consider assigning one person to monitor specifically disclosures of perks
- Review reimbursement requests and reimbursement policies and procedures with perk disclosure standards in mind

Pay Ratio. Mandatory CEO pay ratio disclosure saw its second year in 2019. The SEC's pay ratio rule requires companies to disclose the ratio of the annual total compensation of the median company employee to the annual total compensation of the CEO.

Generally, companies need to identify the median employee only once every three years. Companies should, however, consider whether re-calculation of the median employee is necessary or appropriate for the 2020 proxy season in light of material changes to the workforce composition or compensation arrangements. Even if a company could continue to use the same median employee it used in 2019, the pay ratio rule does not prohibit a company from identifying a new median employee every year.

Institutional Investor and Proxy Advisor Areas of Focus

Institutional Shareholder Services (ISS) and Glass Lewis released their 2020 proxy voting guidelines in November 2019. The Glass Lewis 2020 Proxy Guidelines are available here. The ISS updates came in the form of an executive summary of its benchmark policy updates and a more detailed comparison showing changes to its policies. Below we highlight a few of these proxy advisors' guideline updates, as well as institutional investor areas of focus, for companies to consider as they draft their proxy statements and prepare for annual meetings.

Board Gender Diversity. Institutional investors and proxy advisors remain keenly focused on board gender diversity. ISS will generally recommend against nominating committee chairs (and potentially other directors) at Russell 3000 and S&P 1500 companies where there are no women directors, absent certain mitigating factors.

Glass Lewis has had a similar policy in effect since the beginning of 2019. For companies with all-male boards, a firm commitment to appoint one woman director within a year will be a mitigating factor for ISS in 2020 but not for subsequent years.

California's board diversity law requires publicly traded companies formed or headquartered in California to include women on the boards of directors. The phased-in requirements provide that all covered companies must have at least one woman director by the end of 2019. The requirement increases to three, two and one women for boards of six or more directors, five directors and four directors, respectively, by the end of 2021.

Shareholder Proposals. ISS and Glass Lewis provided additional guidelines for their approaches to certain shareholder proposals. ISS largely codified its existing practice with respect to independent board chair proposals by identifying six factors that will increase the likelihood of a recommendation in support of such a proposal, including poor board responsiveness to shareholder concerns, a weak or poorly defined independent director role and risk oversight failures. ISS also added "race or ethnicity" to its existing policy to vote on a case-by-case basis for shareholder "pay gap" proposals seeking reports on a company's pay data. Companies saw a record number of pay gap proposals in 2019, with 28 such proposals filed.

Glass Lewis announced it will evaluate gender pay equity proposals on a case-by-case basis and will generally recommend against such proposals where companies have provided adequate information regarding their diversity initiatives and details about how they guarantee men and women equal pay for equal work.

In response to the SEC's new approach to responding to no-action requests to exclude shareholder proposals, Glass Lewis will generally recommend voting against governance committee members where the company chooses to exclude a proposal from its proxy statement if the staff declined to state a view as to whether a shareholder proposal may be excluded.

Problematic Governance Practices—Newly Public Companies. The ISS guidelines clarify and narrow the scope of what are considered problematic governance practices at newly public companies that may warrant recommending against the board. These are supermajority vote requirements to amend the charter or bylaws, a classified board or any other "egregious" provisions, though ISS will consider a "reasonable" sunset provision as a mitigating factor. ISS will similarly recommend against the board if a company maintains a multi-class capital structure with unequal voting rights without a reasonable, time-based sunset provision. The sunset period must not exceed seven years post-IPO, and ISS will consider the company's lifespan, post-IPO ownership structure and the board's disclosed rationale for the sunset duration.

Board Attendance and Committee Performance. ISS continues to maintain its policy of voting against directors who attend less than 75% of board and committee meetings. For 2020, however, ISS revised its board and committee attendance policy to exempt nominees who served only part of the year, instead of any "new nominees," which may have the effect of exempting certain new directors for two annual meetings. For example, a director who joined the board in February 2020 before a May 2020 annual meeting would be exempt from the ISS attendance policy for both 2019 (at the 2020 annual meeting) and 2020 (at the 2021 annual meeting).

Glass Lewis will generally recommend voting against the governance committee chair when directors' records for board and committee meeting attendance are not disclosed or the company discloses that a director attended less than 75% of board and committee meetings, but it is not possible to determine which specific director's attendance was lacking.

Executive and Equity Compensation Matters. For the 2020 proxy season, ISS will incorporate its economic value added (EVA) metrics in the secondary financial performance assessment screen of its quantitative pay-for-performance model. ISS also added the presence of an evergreen feature in an equity plan as an "overriding factor" in its equity plan scorecard (EPSC), which feature may trigger a negative vote recommendation on an

equity plan proposal.

The latest Glass Lewis guidelines provide that it will generally recommend against all compensation committee members for failure to adopt the say-on-pay vote frequency approved by shareholders. Glass Lewis may also recommend against a company's say-on-pay proposal if the company does not provide robust disclosure of engagement activities and specific changes made in response to shareholder feedback following low shareholder support (80% or below) for the prior year's say-on-pay proposal.

Other 2020 Proxy and Annual Reporting Matters

Critical Audit Matters. The new auditor reporting standards regarding disclosure of critical audit matters (CAMs), previously approved by the SEC in 2017, are beginning to be required in auditor reports filed on EDGAR. A CAM is defined as any matter arising from an audit that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements and (2) involves especially challenging, subjective or complex auditor judgement.

The CAM disclosure rules apply to auditor reports related to the following:

- Fiscal years ending on or after June 30, 2019, for large accelerated filers
- Fiscal years ending on or after December 15, 2020, for all other companies that are required to file auditor reports

Once the CAM disclosure rules apply to a company, all auditor reports must include disclosure of any CAMs or a statement from the auditor that no CAMs exist for the period under audit. The rules go beyond identifying the mere existence of a CAM, requiring the auditor to describe why a matter is a CAM and how it was addressed during the audit.

New Disclosure Simplification Rules Adopted. This spring, the SEC adopted additional rule amendments to modernize and simplify certain disclosure requirements, as mandated by the FAST Act. Changes companies should make for the 2020 reporting season include the following:

Form 10-K Cover Page

- Previously required disclosure for securities registered pursuant to Section 12(b) should be replaced with a table showing the title of each class of securities registered, the trading symbol and the name of the exchange where the securities are registered. This table should appear immediately below the company's telephone number.
- Reference to delinquent Section 16 filings and related checkbox should be eliminated.
- Cover page data should be tagged in Inline XBRL, subject to the compliance schedule discussed below in "*Inline XBRL*."

Form 10-K Exhibits

- A new exhibit, required by Item 601(b)(4)(vi) of Regulation S-K, must be included containing a description required by Item 202(a) through (d) and (f) of Regulation S-K for each class of securities registered under Section 12 of the Exchange Act. This exhibit may be prepared in advance of the Form 10-K preparation process. A useful starting place is the descriptions of securities previously filed with the SEC on Form 8-A or in Securities Act registration statements, but companies should consider whether any updates are required.

- An exhibit with respect to cover page items that are tagged in Inline XBRL must be included, as discussed below in "*Inline XBRL*."
- Only material contracts that would be performed in whole or in part after filing should be filed. Companies (other than newly reporting companies) are no longer required to file material contracts that are fully performed and entered into within two years before the filing. Therefore, most companies can review last year's exhibit list, remove any completed material contracts and only add material contracts with unperformed obligations.

Form 10-K MD&A

- The discussion in MD&A of the earliest of the three years included in the financial statements may be excluded, if such discussion was included in the registrant's prior filings and the current filing identifies where such discussion may be found. Companies that have undertaken major acquisitions or realigned segments in a recent period may find that the prior discussion is no longer materially aligned with its financial statement disclosures. In such a case, the company would likely include discussion of the earliest year in the current filing.

Form 10-K Directors, Executive Officers, Promoters and Control Persons

- The caption for Item 401 disclosure (if included in Part I of Form 10-K) should be changed to "Information about our Executive Officers" from "Executive officers of the registrant."

For additional information on this year's FAST Act Disclosure Simplification Amendments, please refer to our April 2019 update.

ESG Disclosures. Many companies, including both the largest issuers and, increasingly, mid-caps, are facing growing pressure from investors to provide additional disclosures on environmental, social and governance (ESG) topics. These calls for disclosure go beyond what is required by SEC rules. In response to investor pressure, through off-season shareholder engagement, shareholder proposals under Rule 14a-8 and other channels, companies are increasingly providing ESG disclosures in proxy statements and in separate sustainability reports posted to corporate websites. For more information regarding ESG disclosure trends, see our August 2019 corporate governance topics update.

Inline XBRL. On June 28, 2018, the SEC issued final rules mandating the use of eXtensible Business Reporting Language (XBRL) in SEC filings on a phased-in basis. Companies may choose to comply with the rules on a voluntary basis prior to their applicable compliance effective dates. Inline XBRL allows a reporting company to embed XBRL data directly into the text of its filings, rather than tagging text with links to filing exhibits.

As we described in our December 2018 update, the phased-in compliance period for using Inline XBRL is as follows:

- For large accelerated filers that prepare their financial statement in accordance with U.S. GAAP, fiscal periods ending on or after June 15, 2019
- For accelerated filers that prepare their financial statement in accordance with U.S. GAAP, fiscal periods ending on or after June 15, 2020
- For all other filers, fiscal periods ending on or after June 15, 2021

Companies required to comply with the Inline XBRL rules should note that (1) interactive data files must be specifically identified in the exhibit index by using the word "Inline" within the title of such exhibit and (2) they must tag all cover page data in Inline XBRL on reports (including Forms 8-K that do not contain financial data). In addition, a new exhibit will need to be included on any Form 10-K, 10-Q or 8-K when cover page items are

tagged in Inline XBRL, per item 601(b)(104) of Regulation S-K. In C&DI 101.04, the SEC clarified it would not object to the omission of this exhibit if it would otherwise be the only exhibit on the Form 8-K (*see* the SEC's C&DIs regarding interactive data).

D&O Questionnaires. Companies should consider whether to include the following changes to their annual D&O questionnaires:

- Rather than asking whether all Section 16 reports have been provided to the company, consider asking directors and officers if all required Section 16 reports have been filed on EDGAR
- Though not required, in order to elicit fulsome responses to questions regarding perk disclosures, consider including a basic question inquiring about any direct or indirect benefit received from the company that has a personal aspect

Companies that have questions or require further clarification on these updates should seek guidance from trusted counsel.

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