

A Corporate Governance Guide To 2020 Proxy Season

By Jurgita Ashley



Law360 (1/1/2020) With the 2020 proxy season around the corner, below are a few considerations to keep in mind when drafting annual reports and proxy statements and otherwise preparing for annual shareholder meetings.

Proxy Advisers and Institutional Investors

As the focus on environmental, social and governance, or ESG, issues increases, companies should:

- Review the policies of Institutional Shareholder Services Inc., Glass Lewis & Co. LLC and institutional investors as appropriate based on each company's shareholder base;
- Familiarize themselves with applicable regulatory guidance and federal and state law; and
- Proactively respond to any potential issues.

For example, in 2019, new so-called overboarding and board gender diversity policies led to withheld votes from directors at a number of companies, which is likely to continue in 2020. The effects of the U.S. Securities and Exchange Commission's 2019 guidance directed at proxy advisory firms should also begin to emerge over the coming months,

indicating whether the latest guidance bears any impact on the behavior of investment advisers, proposed conflicts disclosure, and the level of detail of the analytical notes provided in ISS and Glass Lewis reports, particularly in light of the lawsuit filed by the ISS in late October challenging the SEC's guidance.

Current Economic and ESG Issues

As always, companies should consider their disclosures, taking into account the current economic, political, social and governance climate.

In 2020, disclosures regarding economic conditions, tariffs, privacy matters, cybersecurity, anticipated phase-out of Libor after 2021, climate change, sustainability and shareholder engagement are likely to be among the topics to be addressed, as well as Brexit, opioids, guns and immigration, to the extent material to the company. Although few such proposals pass at shareholder meetings, support for environmental and social shareholder proposals, as well as activism on ESG issues, has also been increasing.

In addition, the SEC staff has recently announced that instead of providing written responses to company requests to exclude shareholder proposals

as was the case in the past, it generally intends to provide a summary of its responses on the SEC's website in a chart format. The staff also said that in some cases — with frequency unknown — it may decline to express a view on such no-action requests.

Absent the SEC staff taking definitive positions on such requests, leaving companies facing the uncertainty of potential litigation and negative voting recommendations by proxy advisory firms, companies may be hesitant to exclude shareholder proposals from their proxy materials.

The SEC has further proposed amendments to submission and resubmission thresholds for shareholder proposals, but perhaps less significant in amounts than expected. Some related procedural amendments are also pending.

New SEC Disclosure Modernization and Simplification Rules

The SEC's new disclosure modernization and simplification rules have made some technical changes to SEC filing forms, with more substantive changes potentially impacting the properties disclosure, comparative presentation of results of operations in the management discussion and analysis, and the requirement to include a new securities exhibit with the annual report on Form 10-K.

The SEC has also provided additional guidance regarding inline XBRL format (i.e., embedded

directly into the HTML document) and attendant exhibits, incorporation by reference, hyperlinking, confidential treatment requests, and material contracts that are required to be included in the exhibit index to the Form 10-K.

Companies should familiarize themselves with these requirements, including recent statements by the SEC staff and commissioners regarding cybersecurity, Libor, Brexit and human capital, and evaluate if any changes to their SEC filings are necessary.

When updating and tailoring risk factors, material risks should also be assessed considering management discussion and analysis disclosure, insider trading, and internal controls. In addition, companies should review the last Form 10-K exhibit index, prepare a new securities exhibit, and complete a form check. These tasks may be particularly important this year in light of various technical changes that have been recently implemented, and the SEC's recent realignment of its offices, which may result in an entirely new team reviewing the company's filings this year.

When determining which avenue to utilize in order to exclude sensitive information from an exhibit, despite the SEC's simplified process, a confidential treatment request may still be appropriate in some cases in light of a recent U.S. Supreme Court decision relating to a competitive harm analysis.

Companies should further keep in mind that the SEC, other regulators and institutional investors are

using structured data with increasing frequency to gather information, comparing companies against their peers, monitoring for unusual events and trends, and looking for outliers in the industry.

Additional Proposed SEC Rules

Further proposed rules that may be in final form for the 2020 proxy season, aim to modernize and simplify business descriptions, risk factors and disclosure of legal proceedings. They emphasize a principles-based approach to disclosure, but would also likely require companies to undertake additional efforts in preparing their annual reports, particularly the business strategy section, risk factors and new human capital disclosure.

Proposed changes to financial disclosures regarding acquired and disposed businesses are pending, and so are rules proposing updates to statistical disclosures required to be provided by banks and similar institutions. Under the recently expanded definition of the "smaller reporting company," more companies have been able to take advantage of scaled-down disclosure requirements.

It remains to be seen, however, if any additional relief becomes available from the requirement to provide an auditor report on the effectiveness of internal controls as the SEC's proposed rules to amend the definitions of "large accelerated filer" and "accelerated filer" remain pending.

Critical Audit Matters

The phase-in of critical audit matters, or CAMs, begins for audits of large accelerated filers for fiscal years ending on or after June 30, 2019, and some auditor reports addressing CAMs have already been filed. Audit committees of other filers are likely to engage in mock-up exercises relating to CAMs with their auditors in connection with the 2019 audits, if they have not already done so.

D&O Questionnaires

There have not been any SEC rule changes to date that impact directors' and officers' questionnaires for the 2020 proxy season. However, Nasdaq Inc. has proposed to amend the definition of "family member," which, if approved, may impact some questionnaires and director independence determinations. Companies should also consider to what extent, if at all, they need to collect diversity data, through questionnaires or otherwise.

Proxy Statement Considerations

Companies should continue to assess whether they have enough authorized shares and sufficient shares remaining available for issuance under their equity plans, whether any equity plans are expiring or need to be amended, whether a company is required to hold a say-on-pay frequency vote, whether a say-on-pay proposal is needed in connection with this year's annual meeting and the levels of shareholder support received the last time that the say-on-pay proposal was presented.

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Recall that for shareholder meetings in 2020, ISS intends to vote against compensation committee members (or other directors responsible for setting director compensation) if non-employee director compensation is deemed excessive for the last two or more years.

With regard to the remaining Dodd-Frank rulemaking, the SEC's clawback and pay-for-performance rules are currently still in their proposed form. Although most companies already include disclosures regarding hedging or prohibition from hedging, the final hedging disclosure rule, effective for the 2020 proxy statements for larger companies, is somewhat nuanced and should be reviewed.

From the corporate governance standpoint, do board diversity, risk oversight, related party, shareholder engagement or audit committee disclosures need to be enhanced? For example, the SEC's staff has recently suggested that the board's oversight of the Brexit and Libor-related risks may need to be discussed in the proxy statement if such risks are material to the company.

Further, what is the company hearing from its shareholders? Were there any issues identified by ISS or Glass Lewis last year that should be addressed in the proxy statement? As an example, board diversity has increased as an issue of

importance to many investors, and companies should consider to what extent they should modify their corporate governance policies, processes and disclosures in response. Potential revisions to the SEC's rules relating to the board diversity and audit committee disclosures also remain possible.

It is unclear whether we will see anything from the SEC regarding proxy plumbing reform in time for the 2020 proxy season. Whether or not it is in the area of proxy plumbing, additional rulemaking by the SEC before the 2020 proxy season is likely.

Last but not least, user-friendly presentation of information in annual reports and proxy materials, perhaps combined with sustainability initiatives, remains of interest to many investors.

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