

2018 Navigating the Annual Report and Proxy Season

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2018: Looking Ahead Steven Kennedy

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Finally, a Full Commission



Jay Clayton
Chairman
since 2017
Term exp. 2021



Kara M. Stein
Commissioner
since 2013
Term exp. 2017



Michael S. Plautner
Commissioner
since 2013
Term exp. 2018



Hester Pierce
George Mason Univ
Confirmed 12/21/17



Robert Jackson Jr.
Columbia Law School
Confirmed 12/21/17

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SEC Priorities / Agenda

- ▶ Representative Priorities on the Reg Flex Agenda:
 - ▷ Enforcement and examinations (but not "broken windows")
 - ▷ Capital formation (confidential filings)
 - ▷ Disclosure reform
- ▶ Moved to long-term agenda:
 - ▷ Unfinished Dodd-Frank rulemaking
 - ▶ Pay for performance disclosure
 - ▶ Hedging policies
 - ▶ Clawback rule
 - ▷ Universal proxy ballot
 - ▷ Conflict minerals amendments
 - ▷ Board diversity disclosure

Proposed Rulemaking: Simplify Reg S-K

- ▶ Proposed on October 11 as required by FAST Act
- ▶ Representative proposed changes:
 - ▷ Require only period-to-period comparison for two most recent years in MD&A, so long as discussion of third year is not material to understanding the financial statements and it is discussed in a prior 10-K
 - ▷ Require Section 16(a) discussion only if there are late filings and change heading to "Delinquent Section 16(a) Reports"
 - ▷ Include description of capital stock as an exhibit to 10-K
 - ▷ Allow the omission of attachments and schedules to exhibits unless they contain material information that has not been disclosed otherwise; may require a listing of the schedules/exhibits

Governance Updates

Morgan Burns

Shareholder Proposals in 2017

- ▶ Total number of proposals voted on was down about 8% from 2016, but average support levels increased
 - ▷ Largely driven by decline in proxy access proposals as more companies "voluntarily" adopted
- ▶ Environmental, social and political proposals remain common
 - ▷ Notable themes included climate change, sustainability disclosure, gender pay equity, board diversity, political contributions and lobbying
 - ▷ These proposals rarely passed, though support levels for environmental proposals increased
 - ▶ 3 resolutions on climate change won majority support at energy companies
- ▶ Vast majority of shareholder proposals were received by large-cap companies
 - ▷ S&P 500 companies received nearly 80% of all proposals voted

Most Common Shareholder Proposals in 2017

Proposal Topic	Avg. Support Level
Proxy Access (includes adoptions and amendments)	45%
Climate Change / GHG Emissions	33%
Political Contributions	25%
Environment & Sustainability	27%
Separate Chair/CEO	30%
Lobbying	26%
Board Diversity	28%
Call Special Meetings	42%
Simple Majority Vote	74%
Gender Pay Gap	13%
EEO	29%

Shareholder Proposals – New and Trendy

- ▶ Workforce Diversity
- ▶ Gender Pay Gap
- ▶ Pay Disparity
- ▶ Human Capital Management
- ▶ Minimum Wage Increase
- ▶ Human Lead Exposure
- ▶ Pharmaceutical Pricing
- ▶ Religious Freedom Principles
- ▶ Expansion of Clawback Policies

2017 Shareholder Activism

- ▶ Proxy contests decreased from last year, but still get lots of attention
 - ▷ 38 contests, down from 47 last year
 - ▷ 63 board seats won by activists, down from 139 last year
 - ▷ No one is immune
 - ▶ Recent P&G success narrowly defeating Nelson Peltz despite proxy advisory firms' support for Peltz
- ▶ Placeholder slate tactic – The Williams Companies
 - ▷ Corvex listed 10 of its employees for election to the board as placeholders until Corvex could identify more suitable candidates prior to the election
 - ▷ Contest ultimately withdrawn
 - ▷ Consider requiring nominee to submit written representation that he or she intends to serve as a director and remain on board for full term

Proxy Access Updates

- ▶ Proxy access remains most common corporate governance topic for shareholder proposals in 2017
 - ▷ Most companies adopted proxy access, resulting in fewer proposals going to a vote
- ▶ Of the 49 proxy access proposals voted on in 2017 at S&P 500 companies, 22 sought amendment to an existing proxy access right
 - ▷ "Fix it" proposal topics:
 - ▶ Increase director cap from 20% to 25% of the board
 - ▶ Remove or increase limits on the size of shareholder groups
 - ▶ Remove various other limitations on use of proxy access
 - ▷ None of the "fix it" proposals passed
- ▶ Over 60% of S&P 500 now have proxy access
 - ▷ Most follow 3/3/20/20 formulation

Staff Legal Bulletin 14I

- ▶ Ordinary business exception (Rule 14a-8(i)(7))
 - ▷ Proposals excludable if they deal with a matter relating to the company's ordinary business operations where it is impracticable for shareholders to solve such problems
 - ▷ Proposals not excludable if they raise sufficiently significant policy issues that transcend ordinary business
 - ▷ SEC expects no-action request to include a discussion that reflects the board's analysis of the particular policy issue raised and its significance
 - ▶ Explanation would be most helpful if it detailed the specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned
- ▶ SEC rejected Apple no-action letter including discussion of board's analysis of significance of proposal requesting establishment of a human rights committee

Staff Legal Bulletin 14I

- ▶ Economic relevance exception (Rule 14a-8(i)(5))
 - ▷ Proposals excludable if they relate to operations that account for less than 5% of the company's total assets and less than 5% of its net earnings and gross sales and are not otherwise significantly related to the company's business
 - ▷ SEC expects no-action letter to reflect the board's analysis of the proposal's significance to the company

Staff Legal Bulletin 14I (cont'd)

- ▶ Proposals by Proxy – permitted so long as shareholder delegation:
 - ▷ Identifies the shareholder-proponent and the person or entity selected as proxy
 - ▷ Identifies the company to which the proposal is directed
 - ▷ Identifies the annual or special meeting for which proposal is submitted
 - ▷ Identifies the specific proposal to be submitted
 - ▷ Signed and dated by the shareholder
- ▶ Use of images in shareholder proposals
 - ▷ Images are not prohibited, but any words in the image/graphic counts toward 500 word limit
 - ▷ Some images may be excludable under other grounds (false, vague, misleading, impugn character, so irrelevant as to create uncertainty)

Proposed Rule 14a-8 Reform

- ▶ Financial CHOICE Act proposed updates to 14a-8:
 - ▷ Increase ownership threshold to 1% for a period of 3 years
 - ▶ Up from \$2,000 for one year
 - ▷ Raise the resubmission thresholds to 6%, 15% and 30%
 - ▶ Up from 3%, 6% and 10%
 - ▷ Prohibit shareholder proposals by proxy
- ▶ Reform could have unintended consequences
 - ▷ Could pull some larger, previously passive investors into the mix
 - ▷ Could result in more "vote no" campaigns or other against votes

Director Elections

- ▶ ISS recommended votes “against” over 1,000 directors at more than 500 companies in the Russell 3000
 - ▷ Only 27 directors failed to get a majority vote
 - ▷ 102 directors at S&P 500 companies (2.4%) received less than 80% shareholder support, the highest level since 2011
- ▶ Main reasons for “against” recommendations include:
 - ▷ Independence issues
 - ▷ Shareholders not permitted to amend bylaws (new basis for 2017)
 - ▷ Absence of formal nominating committee
 - ▷ Compensation issues (lack of responsiveness to low say-on-pay vote)
 - ▷ Poor attendance (<75% of meetings)**
 - ▷ Failure of risk oversight due to pledging of shares by executives
 - ▷ Overboarding

ISS Voting Policy Changes

- ▶ Poison Pills – ISS will recommend *against* all board nominees every year if a company has a long-term (more than one year) poison pill that has not been approved by shareholders
- ▶ Shareholder Engagement – If a company receives less than 70% support for prior year’s SOP vote, ISS will consider company’s shareholder’s engagement:
 - ▷ Timing and frequency of engagement
 - ▷ Whether independent directors participated
 - ▷ Specific concerns raised by shareholders and actions taken in response
- ▶ Pledging by Executive Officers and Directors – ISS will recommend against committee members (or full board) that oversees stock pledging if an executive officer or director pledges a significant amount of stock

ISS Voting Policy Changes (cont’d)

- ▶ Board Diversity – ISS will “highlight” companies that do not have any gender diversity on the board
- ▶ Director Attendance Policy – Directors who served for only part of the year and not yet elected by shareholders will generally be exempt
- ▶ Change in Director Classification – Not a substantive change, but ISS will now classify directors as:
 - ▷ Executive Director (previously Inside Director)
 - ▷ Non-Independent Non-Executive Director (previously Affiliated Outside Director)
 - ▷ Independent Director (previously Outside Director)
- ▶ Shareholder Proposals on Gender Pay Gap and Climate Change
 - ▷ Case-by-case on gender pay gap proposals based on certain factors
 - ▷ Guidance on assessing requests for disclosure on climate change

ISS Voting Policy Changes (cont'd)

- ▶ 2019: Non-Employee Director Compensation – ISS will recommend against/withhold board or committee members who approve director compensation if there is a recurring pattern of excess compensation for 2+ consecutive years compared to peers

Glass Lewis Voting Policy Changes

- ▶ Dual-Class Share Structures – Reviewed with heightened scrutiny
- ▶ Board Responsiveness – GL will evaluate board responsiveness to key company proposals (election of directors and SOP) if more than 20% of the votes were cast against
- ▶ Director Commitments – GL clarified that a director who is an executive officer (but not a CEO) of another company may be overboarded if on more than a total of two boards based on the company's disclosure regarding director's responsibilities
- ▶ Pay for Performance – GL clarified that its pay-for-performance rating system, which uses grades (A, B, C, D, etc.) are based on ratings relative to peers
 - ▷ A grade of "C" means that pay and performance are aligned

Glass Lewis Voting Policy Changes (cont'd)

- ▶ Pay Ratio – GL will disclose the CEO pay ratio in its proxy papers, but it won't factor into voting recommendations (at this time...)
- ▶ 2019: Board Gender Diversity – GL will recommend against/withhold from nominating committee chairs (or other board members) of boards with no female directors unless the company discloses a sufficient rationale or plan to address the lack of diversity
- ▶ 2019: Virtual Shareholder Meetings – GL will recommend against governance committee members of companies that plan to hold virtual-only meetings unless shareholders have same rights as available at in-person meetings and discloses those rights in proxy statement
 - ▷ Key issue may be "live" audio/video participation

ISS QualityScore

- ▶ QualityScore name stays the same
 - ▷ CGQ to GRId to QuickScore (up to 3.0) to QualityScore
 - ▷ No substantive changes for US companies
- ▶ ISS is launching an E&S QualityScore to rate companies' environmental and social practices
 - ▷ Disclosure and Transparency Signal
 - ▷ Data verification from Dec 18 – Jan 12
 - ▷ Initial industries include automobiles/components, capital goods, consumer durables & apparel, energy, materials and transportation
 - ▶ Roughly 1,500 companies' scores released in Jan 2018
 - ▶ Additional 3,500 companies in Q2 2018

Executive Compensation Developments

Amy Schneider

Identifying Your Employee Base

- ▶ Step 1: Determine your measurement date
 - ▷ Must be a date within the last three months of your fiscal year
 - ▷ The date is a required disclosure

Identifying Your Employee Base (cont'd)

- ▶ Step 2: Identify all of your employees
 - ▷ Median employee must be identified from among all of your employees employed on the selected measurement date
 - ▷ Employees include the following categories of employees of the company and all of its consolidated subsidiaries:
 - ▶ Full-time and part-time employees
 - ▶ Seasonal and temporary employees
 - ▶ Foreign employees
 - ▶ Salaried and non-salaried employees
 - ▶ Certain independent contractors
 - ▶ Furloughed workers if they are considered employees

Identifying Your Employee Base (cont'd)

- ▶ Step 3: Consider possible exclusions from your employee population
 - ▷ Red Light: Data Privacy Exemption
 - ▶ You may exclude non-U.S. employees if gathering data necessary would violate foreign data privacy rules
 - ▶ Disclosure Required: Yes, and it is lengthy
 - ▷ Yellow Light: Recent Acquisition Exemption
 - ▶ You may exclude the employees of an acquired business (only applicable in year of acquisition)
 - ▶ Disclosure Required: Yes, minimal
 - ▷ Green Light: De Minimis Exemption
 - ▶ You may exclude non-U.S. employees constituting 5% or less of the total employees (5% inclusive of data privacy exemption)
 - ▶ Disclosure Required: Yes, but fairly minimal

Determining Your CACM

- ▶ What is a Consistently Applied Compensation Measure (CACM)?
 - ▷ A CACM used to identify the median employee must *reasonably reflect the annual compensation of your employees*
 - ▷ The SEC clarified this point (regarding use of internal records) in its September 2017 guidance
 - ▷ Internal records may be used
 - ▷ Document the analysis, including material assumptions, adjustments or estimates
 - ▷ Common CACMs include:
 - ▶ Base salary / wages - be clear whether you are including overtime pay
 - ▶ Total cash compensation, which includes base salary and cash bonuses or wages and commissions/bonuses
 - ▶ Taxable wages

Determining Your CACM (cont'd)

▶ CACM 101

- ▶ CACM may use a period different from the company's fiscal year
- ▶ The CACM is not required to include the Measurement Date
- ▶ You may annualize compensation of permanent employees who were only employed for part of the year
- ▶ You may not adjust compensation on a full-time equivalent basis for part-time, temporary or seasonal employees
- ▶ Cost of living adjustments (COLAs) may be used to identify the median employee

WARNING: COLA disclosure is lengthy and you are still required to disclose your non-COLA pay ratio as well

Identify the Median Employee

- ▶ Identify the ME from among all employees other than the CEO using the CACM selected
- ▶ ME must be an actual employee
- ▶ If ME is an "outlier" you may substitute another similarly situated employee and disclose it
- ▶ The ME only needs to be identified once every three years, unless you experience:
 - ▶ significant changes in your employee population OR
 - ▶ significant changes in your employee compensation arrangements
- ▶ If changes are significant as compared to last year, re-run calculations and identify a new ME

Alternative Approach: Statistical Sampling

- ▶ Our Company Is Too Complicated For All That - The Case for Statistical Sampling
 - ▶ Statistical sampling may be a useful alternative if you have:
 - ▶ a complex workforce utilizing many different pay structures; or
 - ▶ incompatible payroll systems across the world making it difficult to identify the actual ME
 - ▶ You can use ≥ 1 sampling method or a combination of methods combined with reasonable estimates
 - ▶ Proceed with caution. Sampling may be challenging to use without input from statistical consultants
 - ▶ If pursuing sampling, consult the final rules, SEC interpretive guidance and your compensation consultant well in advance

Calculating Ratio & Preparing Disclosure

- ▶ Step 1: Calculate the Total Compensation of the Median Employee (ME) and the CEO
 - ▷ Calculate ME's total compensation consistent with the SCT rules
 - ▷ You can include perquisites (>\$10,000) and non-discriminatory benefits in ME's total compensation. However, if you do so, include parallel CEO benefits in the CEO's total compensation for ratio purposes
 - ▷ Explain difference between the CEO's total compensation used for pay ratio versus the amount listed in the SCT

Calculating Ratio & Preparing Disclosure (cont'd)

- ▶ Step 2: Calculate the Pay Ratio
 - ▷ Present a reasonable estimate of the pay ratio, as either a ratio (e.g., 20 to 1 or 20:1) or a multiple (e.g., 20 times)
 - ▷ If labeling ratio as a "reasonable estimate," also state that it has been calculated consistent with Reg. S-K Item 402(u)

Calculating Ratio & Preparing Disclosure (cont'd)

▶ Step 3: Crafting Your Disclosure

Required Disclosure	Voluntary Disclosure
<ul style="list-style-type: none"> • The median of the annual total compensation of all employees of the company (excluding the CEO and any employees excluded under a permitted exemption). • The annual total compensation of the CEO. • The Pay Ratio. • The Measurement Date. • Currency Conversion Rates, if applicable. • The CACM and the related compensation measurement period (disclose what it includes; it may be helpful to note what it excludes as well). • Any exemptions you used to exclude employees (including exemption-specific disclosures). • The methodology used to identify the median employee (e.g., annualizing adjustments, COLAs, substitutions if not using the actual median because he/she was an outlier). • Material assumptions, estimates or adjustments used in identifying the median employee or to determine total compensation or elements thereof (including Statistical sampling methods, if applicable). 	<ul style="list-style-type: none"> • Identifying the pay ratio as a "reasonable estimate" and noting that it was calculated in a manner consistent with Item 402(u) of Regulation S-K. (TBD Recommendation) • General information regarding the median employee (excluding personally identifiable information). For example, position, geographic location, hourly v. salaried, etc. • Rationale or background behind selection of measurement date, CACM, use of de minimis exemption, etc. • One or more additional ratios, based on alternative calculations (may not be misleading or more prominent than required ratio). (Warning: consider precedential value) • Disclaimers that the calculations and resulting ratio are company-specific, making comparisons to peers' pay ratio information challenging or possibly inaccurate.

Calculating Ratio & Preparing Disclosure (cont'd)

- ▶ Step 4: Where Should It Go?
 - ▷ Pay ratio disclosure need not be included in CD&A
 - ▷ Possibly a separate section following the executive compensation disclosure (including all tables)

Calculating Ratio & Preparing Disclosure (cont'd)

- ▶ Step 5: What's My Liability? / Best Practices
 - ▷ Pay ratio disclosure is "filed" with the SEC (rather than "furnished") and subject to Section 18 of the Exchange Act
 - ▷ SEC has stated if your estimates, assumptions and methodology are reasonable, pay ratio disclosure would not provide the SEC with a basis for enforcement actions *unless the disclosure was made or reaffirmed without a reasonable basis or provided other than in good faith*
 - ▷ Consider whether to adjust SOX back-up certifications
 - ▷ Study whether additional disclosure controls and procedures should be implemented

Calculating Ratio & Preparing Disclosure (cont'd)

- ▶ Step 6: Documenting Your Process For Internal Purposes
 - ▷ Your process should be *reasonable, reliable and repeatable*
 - ▷ What does this mean?
 - ▶ Make sure someone can recreate it next year if you win the Powerball and move to Tahiti
 - ▶ Document the analysis, including material assumptions, adjustments or estimates, you use to "determine total compensation or any elements of total compensation"
 - ▶ Also consider documenting (for internal purposes only):
 - ▶ your employee workforce data collection process, including assumptions made and questions examined; and
 - ▶ other CACMs you considered but ultimately did not choose, noting why they were not chosen

Don't Put Off Until Tomorrow What You Can Do Today

- ▶ Preparing Pay Ratio Related Communications (In Advance of Disclosure)
 - ▷ Anticipate constituencies who may be interested in your pay ratio, including:

Employees	Institutional Investors
Labor Unions	ISS / Glass Lewis
Local Press	
 - ▷ Develop a cohesive and tailored communications strategy in advance of required disclosure
 - ▷ Strategy should consider the communication's timing, method and medium
 - ▷ Consider potential audience sensitivities
 - ▷ Determine whether communication will trigger additional SEC disclosure obligations

ISS Equity Plan Scorecard – 2018 Revisions

- ▶ Increase in number of points required to get favorable voting recommendation to 55 for S&P 500 companies (remains 53 for others)
- ▶ Change in control vesting
 - ▷ Full credit given if:
 - ▶ Time-based awards are not subject to automatic single trigger accelerated vesting or discretionary accelerated vesting
 - ▶ Performance-based awards :
 - ▷ Forfeit or terminate or
 - ▷ Are not subject to accelerated vesting or
 - ▷ Accelerate either on a pro rata basis at target or actual performance as of CIC
 - ▷ No points if plan provides for automatic or discretionary accelerated vesting for time-based awards or above actual or pro rata target level for performance-based awards (no partial credit)

ISS Equity Plan Scorecard – 2018 Revisions (cont'd)

- ▶ Retained discretion over acceleration events
 - ▷ Full points if committee does not have discretion to accelerate in events other than death or disability
 - ▷ Credit no longer available if discretion retained over acceleration for CIC
- ▶ CEO vesting
 - ▷ Full points if vesting is ≥ 3 years from the date of grant for all award types (time-based and performance-based)
 - ▷ No points if vesting is < 3 years (no partial credit)
- ▶ Holding period
 - ▷ Full points if holding period is at least 12 months or to the end of employment
 - ▷ No points if holding period is less than 12 months or if holding period applies until stock ownership guidelines are met (no partial credit)

ISS Quantitative P4P Screens – 2018 Revisions

- ▶ Threshold for “medium” level of concern on the Multiple of Median screen for S&P 500 companies will change from 2.33 to 2.00
- ▶ First and last months of TSR measurement period will be averaged to reduce the impact of point-in-time stock price fluctuations
- ▶ Financial Performance Assessment added to quantitative P4P screen; will rank CEO pay and company performance within a peer group over a 3-year period based on three or four of:
 - ▷ ROIC
 - ▷ ROA
 - ▷ ROE
 - ▷ EBITDA Growth

SOP and Equity Plan Proposals – ISS Influence

- ▶ Say-on-pay proposals continue to receive high levels of support
 - ▷ 99% pass with majority support (99.5% for S&P 500)
 - ▷ ISS recommended against approximately 12% of proposals (only 9% at S&P 500 companies)
 - ▶ Average support where ISS recommended “for” was 95%
 - ▶ Average support where ISS recommended “against” 70%
- ▶ Approximately 720 equity plan proposals submitted by Russell 3000 companies in 2017
 - ▷ ISS recommended against approximately 20% of the proposals (only 4% of proposals at S&P 500 companies)
 - ▶ Average support where ISS recommended “for” was 93%
 - ▶ Average support where ISS recommend “against” was 77%
 - ▷ Only three proposals failed to get majority support

Tax Reform – What To Do Now

- ▶ Tax reform changes take effect for tax years beginning on or after January 1, 2018
- ▶ Corporate rate will decrease from 35% to 21%
- ▶ Several companies took advantage of opportunity to accrue and deduct amount for bonuses in 2017
 - ▷ Some companies deducted for bonuses routinely even before tax reform
 - ▷ Companies generally had compensation committee approve a minimum bonus pool amount for deduction purposes, which was a percentage (perhaps 85-95%) of the expected amount of bonuses to be paid
 - ▷ Process for certifying actual payouts after end of performance period remains the same
 - ▷ If amount ultimately paid is no less than the amount of the pool, the amount of the pool should be deductible in 2017

Changes to 162(m) Under Tax Reform

- ▶ Eliminates exemption for performance-based compensation
 - ▷ Any and all compensation over \$1 million to a "covered employee" will be non-deductible
- ▶ "Covered employee" includes:
 - ▷ CEOs during fiscal year
 - ▷ CFOs during fiscal year (previously not covered)
 - ▷ Three highest paid executive officers (other than CEOs/CFOs)
- ▶ Anyone who is a covered employee based on 2018 proxy statement or later remains a covered employee
- ▶ Transition provision retains exemption for written binding agreements in effect on November 2, 2017 and not subsequently amended
 - ▷ Must be an obligation to pay the award

Changes to Incentive Awards Going Forward

- ▶ No need to comply with certain 162(m) requirements:
 - ▷ No more need to use umbrella plans (plan-within-a-plan) structure
 - ▷ Positive discretion can be exercised
 - ▷ Awards can be based on subjective factors
 - ▷ Performance criteria can be set or amended more than 90 days (25%) into performance period
 - ▷ Compensation committee members won't need to qualify as "outside directors"
 - ▷ Performance metrics don't need to be approved by shareholders every five years

Don't Get Too Carried Away!

- ▶ HOWEVER, exercising positive discretion, using subjective factors and amending performance criteria still require disclosure and may give rise to proxy advisory firm/shareholder concerns
- ▶ Don't get so carried away as to forget that other requirements still apply:
 - ▷ Stock exchange rules
 - ▷ Section 16 approval requirements
 - ▷ 409A
 - ▷ Disclosure considerations
- ▶ Until you have a firm handle on which awards may be grandfathered, it may make sense to keep 162(m) practices in place

162(m) FAQs

- ▶ Do I need to amend any of my plan documents?
 - ▷ Probably not. Most plan documents provide that stricter 162(m) provisions only apply to awards intended to qualify as performance-based under 162(m), but also permit performance awards that are not intended to so qualify.
- ▶ Do I need to supplement or amend my plan prospectuses?
 - ▷ Technically yes. The Form S-8 prospectus rules require that the prospectus briefly describe the tax effect to employees *as well as the tax effect, if any, upon the registrant*. Accordingly, many prospectuses describe the impact of 162(m)-qualified performance-based compensation. That description may no longer be accurate. That said, since the change to 162(m) does not affect the tax effects on employees, there is probably little practical risk if the prospectus is not amended/supplemented timely.

162(m) FAQs

- ▶ Do I need to disclose the amount of executive compensation that is not deductible?
 - ▷ No. You should make sure that your disclosure regarding 162(m) is current and reflects the status of tax reform, but we don't see a reason why you need to quantify the amount of non-deductible compensation.
- ▶ Is this expected to result in substantive changes to compensation structures and amounts?
 - ▷ No. While 162(m) was instrumental in moving companies towards performance-based initially, performance-based pay is here to stay for other reasons. We don't believe that comp committees generally approved pay types or amounts because they were deductible. Rather, they approved the types/amounts they thought were appropriate and sought to make them deductible when and to the extent possible.

Cybersecurity Governance

Paul Luehr

Threat Landscape: Data Breach Costs

\$7.4M

U.S. average cost of a data breach (\$3.6 M globally)

12%

Increase since 2016, in U.S. cost of a breach (10% decrease globally)

\$225

U.S. average cost for each exposed record (\$141 globally)

Threat Landscape: Data Breach Costs

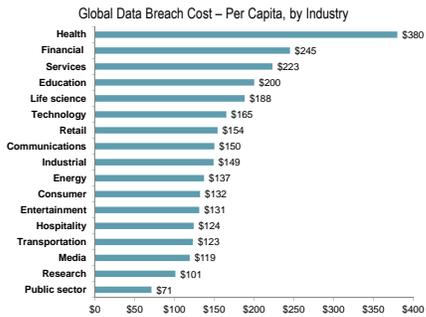
65%

Indirect Costs:
Staff hours
Lost Goodwill
Customer "Churn"

35%

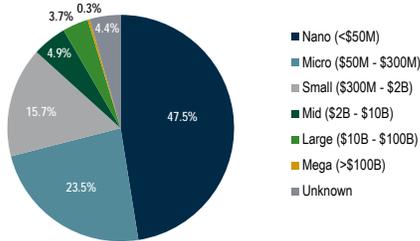
Direct Costs:
Outside Counsel
Outside Experts
ID Theft Insurance
Notification Costs

Threat Landscape: Data Breach Costs



Threat Landscape: Data Breach Costs

Data Breach Insurance Claims
by company revenue size



Source: NetDiligence: 2017 Cyber Claims Study

Threat Landscape: Litigation and Lost Reputation

Home Depot Settles Data Breach-Related Derivative Lawsuit

Wyndham Execs Escape Derivative Suit Over Cyberattacks

Trying to Stem Fallout From Breach, Equifax Replaces C.E.O.

Threat Landscape: Heavier Regulation

Financial Planning All Sections - SEC Warns More Cyber Enforcement Actions Coming

- ▶ **Timing & Disclosures**
 - ▷ What did Company/Execs/Board know, when?
 - ▷ 8-K, 10-Q, 10-K Obligations
 - ▷ Regulation FD
- ▶ **Insider Trading**
- ▶ **Cybersecurity Violations**
 - ▷ GLBA "Safeguards Rule," adopted as part of Regulation S-P
 - ▷ FINRA Actions - Regulations S-P, S-ID, 17 CFR §240.17a-4(f)

Threat Landscape: Heavier Regulation



- ▶ NY DFS - "First-in-the-Nation" Cybersecurity Requirements
 - ▷ Effective August 28, 2017
- ▶ NAIC – Insurance Data Security Model Law
 - ▷ Passed October 24, 2017
- ▶ EU – General Data Protection Regulation
 - ▷ Effective May 25, 2018

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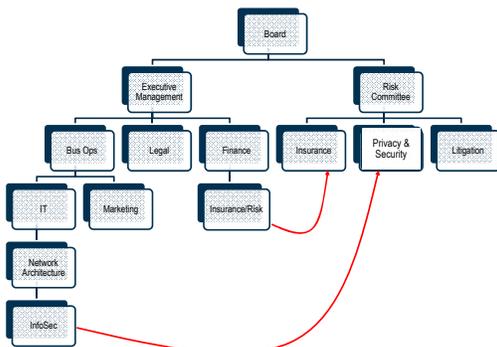
Cybersecurity Governance – Best Practices

- ▶ Organizational Structure
- ▶ Program
- ▶ Communications
- ▶ Resources



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Organizational Structure



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Cybersecurity Program: Data Mapping

- ▶ Types of Data
 - ▷ PII
 - ▷ PHI
 - ▷ Confidential, Trade Secrets
- ▶ Locations of Sensitive Data
 - ▷ Geography
 - ▷ Device or function
 - ▷ Flows



Cybersecurity Program: Adopt a Framework

NIST Cybersecurity Framework (CSF)

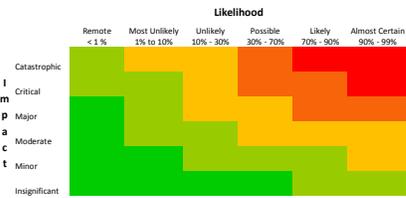
- | | | | | |
|---|---|---|--|--|
| IDENTIFY <ul style="list-style-type: none"> • Asset management • Business environment • Governance • Risk assessment • Risk management strategy | PROTECT <ul style="list-style-type: none"> • Access control • Awareness and training • Data security • Information protection and procedures • Maintenance • Protective technology | DETECT <ul style="list-style-type: none"> • Anomalies and events • Security continuous monitoring • Detection process | RESPOND <ul style="list-style-type: none"> • Response planning • Communications • Analysis • Mitigation • Improvements | RECOVER <ul style="list-style-type: none"> • Recovery planning • Improvements • Communications |
|---|---|---|--|--|



Cybersecurity Program: Conduct Risk Assessments

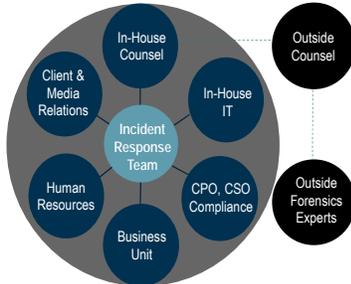
Assess Risk

$$\text{RISK} = \text{Vulnerabilities} \times \text{Threats} \times \text{Impact} \times \text{Probability}$$



Cybersecurity Program - Incident Response (IR) Team

- ▶ Multiple Representatives
- ▶ Realistic Triggers
- ▶ Counsel as Lead
- ▶ Contact Sheets for:
 - ▷ Outside counsel
 - ▷ Forensic experts
 - ▷ Crisis communicators
 - ▷ Notification firms
 - ▷ Law enforcement
 - ▷ Insurance agent/broker



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Cybersecurity Program: IR Plan

- ▶ Include:
 - ▷ Specific "playbooks"
 - ▷ Escalation paths
- Crisis Management Team
 ↑
 IR Team
 ↑
 Info. Security
 ↑
 Help Desk
- ▶ Regulatory drivers
 - ▶ Risk levels
 - ▶ Timing expectations

Threat Level	Impact	Response Team	Threat Type	Response Goals
Crisis	Corp. - Global	Crisis Comms Global IR Local IR Tech	Facility Shutdown	2 hours
Major Incident	Corp. - Regional Corp. Strategy Affected	Global IR Local IR Tech	Stolen IP	24 hours
Minor Incident	Corp. - Local Loss of Bus. Data	Local IR Tech	Lost, encrypted laptop	48 hours

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Communications

- ▶ Crisis Communications (connected to IR Plan)
 - ▷ Escalation plan – what is Board-worthy, timing expectations
 - ▷ Communications plan – who/when to address press, investors, etc.
 - ▷ Legal compliance – consistent facts in 8-K, FAQs, press release
- ▶ Risk Committee Debates
 - ▷ Security v. efficiency v. convenience
 - ▷ Ethical issues – ransomware payments
 - ▷ Insurance coverage
- ▶ Regular Board Reports (quarterly or annually)
 - ▷ New risks
 - ▷ Security plan milestones



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Resources

► Staffing

- ▷ Internal IT & Security
- ▷ External advisors

► Tools

- ▷ Software, hardware upgrades
- ▷ Monitoring tools

► Budget

- ▷ Staffing
- ▷ Operations – pen testing, vulnerability scans, annual assessments
- ▷ IR Preparedness – tabletops, war games



* Gartner recommends allocating 4 - 7% of IT budget to security

20 Updates and Reminders in 20 Minutes

Josh Colburn

#20 – Conflict Minerals Year 5

► 2015 appellate decision reaffirmed that the rule

- ▷ violated First Amendment
- ▷ to extent it required companies to report and state that products have "not been found to be "DRC conflict free"



► April 2017 judgment remanded case to the SEC

► Division of Corporation Finance guidance = no recommendation for enforcement action against companies that:

- ▷ Only perform reasonable country of origin inquiry (RCOI) and provide only disclosures required in Form SD
- ▷ Even if they don't provide detailed supply chain due diligence disclosure, Conflict Minerals Report (CMR) or independent private sector audit

► Most companies just did the same thing as in the prior year

#19 – Say on Pay Frequency – Round Two

- ▶ For 2017, annual say-on-pay recommended by management & received shareholder preference at
 - ▷ >88% of Russell 3000
 - ▷ >95% of S&P500
- ▶ Support for triennial say-on-pay declined from nearly 20% in 2011 to about 8% in 2017
 - ▷ A few notable institutions prefer triennial vote (BlackRock)
 - ▷ Rationale is that they can vote against compensation committee members for poor pay practices when say on pay is not on the ballot
- ▶ Decision about frequency must be disclosed in 8-K reporting meeting results or an 8-K/A within 150 days of the meeting
- ▶ Next frequency vote in 2023

#18 – Director Compensation Litigation

- ▶ Delaware Supreme Court applied "entire fairness" test to director compensation (*In re Investors Bancorp, 2017*)
 - ▷ Court said board must be divested of all discretion in awarding itself compensation before business judgement rule applies
 - ▶ Stockholders approve specific director awards or
 - ▶ Plan needs to be self-executing
 - ▷ Departure from the prior "meaningful, director-specific limits" approach
 - ▶ Limit in the shareholder-approved plan provided that 30% of all options or restricted shares available could be awarded to directors
- ▶ Bad facts make bad law?
 - ▷ Awards averaged \$2M, granted days after shareholder approval of plan
 - ▷ Peer company awards averaged \$175,817

#17 – Exhibit Hyperlinking

- ▶ Effective September 1, 2017 for all accelerated filers
 - ▷ September 1, 2018 for non-accelerated & smaller reporting companies
- ▶ All exhibits, including those filed with the report/registration statement, must be hyperlinked, other than:
 - ▷ Exhibits filed in paper under hardship exemptions (requires notation)
 - ▷ XBRL exhibits
 - ▷ Exhibits that pre-date electronic filings (i.e., re-filing is NOT required)
- ▶ Some "old" exhibits are contained in single ASCII file:
 - ▷ hyperlink to entire filing, but identify the specific exhibit; or
 - ▷ re-file the exhibit and hyperlink to refiled version
- ▶ Hyperlinked exhibit list must appear before the signatures
 - ▷ Second "exhibit index" before the exhibits no longer appropriate

#16 – D&O Questionnaires

- ▶ No new questions required this year!
- ▶ But:
 - ▷ Confirm that your AS 18 questions reflect best practices and satisfy your current audit team
 - ▷ If you intend to disclose gender and/or race diversity of your directors, consider whether you should ask them to self-identify
 - ▷ you can delete questions targeted solely to “outside director” status once all performance-based pay under “old” 162(m) exemption has been paid out

#15 – NYSE Notice/Filing Updates

- ▶ NYSE adopted rule requiring companies to delay release of material news until:
 - ▷ publication of the company's official closing price; or
 - ▷ five (5) minutes after official market close (i.e., 3:05 pm CT)
- ▶ NYSE proposed rule would eliminate requirement to send in paper copies of proxy materials to NYSE so long as they are filed on EDGAR
 - ▷ SEC proposed rule on December 6
 - ▷ Could be effective as early as late January 2018



#14 – NASDAQ or Nasdaq?

- ▶ Nasdaq issued rulemaking on October 23, 2017 changing capitalization of NASDAQ to Nasdaq in all versions of its name
 - ▷ Rulemaking was effective immediately
 - ▷ Described as non-substantive corporate branding change
- ▶ Nasdaq website and even recent emails from various Nasdaq personnel still use all caps
- ▶ Issuer adoption has been spotty



The quick ~~NASDAQ~~ jumped over the lazy dog.

#13 – Tax Reform – Do You Need a Form 8-K?

- ▶ It depends, but probably not.
- ▶ If you are only re-measuring your deferred tax assets, then no 8-K (re-measuring is not itself an impairment).
 - ▷ SEC issued interp on Dec 22 confirming this approach
- ▶ If conclude that a material impairment of a deferred tax asset is required under GAAP, then a Form 8-K *may* be required:
 - ▷ However, note instruction to Item 2.06: if the impairment occurs in connection with or coincident to preparation of the financial statements, then no 8-K

#12 – Tax Reform – Other '34 Act Disclosures

- ▶ Financial Statements and MD&A
 - ▷ Be sure to discuss material impact(s) of tax reform on tax rate(s)
- ▶ Non-GAAP financial measures
 - ▷ Once impact of tax law changes are reflected in financial statements, excluding impact of change generally creates a non-GAAP financial measure
- ▶ Impact(s) on incentive compensation
 - ▷ Follow appropriate procedures and disclose adjustment(s) to any performance metrics impacted by change in tax rates

#11 – Accounting Policy Changes – Revenue/Leases

- ▶ Significant accounting changes coming:
 - ▷ Revenues (effective for interim/annual periods beginning after December 15, 2017)
 - ▶ Full retrospective
 - ▶ Modified retrospective
 - ▷ Leases (effective for interim/annual periods beginning after December 15, 2018)
- ▶ SEC comments remind issuers to disclose impact of changes
 - ▷ If unable to quantify impact, provide qualitative disclosures of potential impact on financial statements
 - ▷ Describe status of process to implement new standard and any significant implementation matters not yet addressed

#10 – Audit Reports - CAMs

- ▶ Changes coming to audit reports for fiscal years ending on/after December 15, 2017, including:
 - ▷ New format w/ headings
 - ▷ New disclosure about auditor tenure
- ▶ Most significant change will require disclosure of critical audit matters (CAMs)
 - ▷ Audit matters that involve especially challenging, subjective or complex judgment, as determined by a reasonable auditor
 - ▷ Use the next two years to do dry-run and understand what your auditor may view to be a CAM
 - ▷ CAM disclosure will apply to audits for fiscal years ending on/after June 30, 2019 for large accelerated filers
 - ▶ Fiscal years ending on/after December 15, 2020 for all other non-EGCs

#9 – Audit Committee Transparency

- ▶ Center for Audit Quality released most recent Transparency Barometer November 2017
 - ▷ Increase from 31% (2016) to 37% (2017) of companies disclosing audit committee considerations in appointing audit firm
 - ▷ Other disclosures on the rise include:
 - ▶ 63% disclose length of audit firm tenure
 - ▶ 20% state that audit committee is responsible for fee negotiations
 - ▶ 38% discuss criteria for evaluating audit firm
 - ▶ 21% disclose that audit firm is evaluated annually
 - ▶ 49% state audit committee is involved in selection of audit engagement partner
 - ▶ 46% state that engagement partner rotates every five years

#8 – “Known Trends & Uncertainties”

- ▶ S-K Item 303 (MD&A) requires disclosure of *“known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations”*
- ▶ Circuit split on private securities fraud claims under this requirement
 - ▷ Second Circuit – yes, private right of action
 - ▷ Third and Ninth Circuits – no private right of action
- ▶ SCOTUS granted cert on case involving this issue for oral argument in November 2017 (*Leidos, Inc. v. Indiana Public Retirement System*)
 - ▷ Case settled in advance, no SCOTUS decision forthcoming
- ▶ Reminders:
 - ▷ Consider this disclosure requirement for each filing; seek out any such trends or uncertainties that may be disclosed on earnings call

#1 – Even EDGAR Can Be Hacked

- ▶ SEC reported that test filings on EDGAR were hacked
 - ▷ hack discovered in 2016; not disclosed publicly until 2017
 - ▷ no personally identifiable information (PII) disclosed
 - ▷ evidence that information was used to facilitate insider trading
- ▶ SEC Statement on Cybersecurity
 - ▷ Information about SEC hack was buried in longer article
- ▶ SEC advice to issuers
 - ▷ Don't include confidential information or PII in test filings
 - ▷ Longstanding staff position allows omission of PII from ALL filed exhibits without a confidential treatment request (CTR)

Proxy Design: Telling Your Story

Amy Seidel

Well-Established Proxy Design Features

- ▶ Executive summaries (full proxy and CD&A)
- ▶ Committee composition and information
- ▶ Performance graphs/charts (including pay for performance)
- ▶ Compensation disclosures
 - ▷ Compensation elements
 - ▷ Mix of compensation
 - ▷ Peer groups

Letter from Chairman / Lead Director / Board

- ▶ Who is the letter from?
 - ▷ CEO/Chair
 - ▷ CEO and Independent Chair/Lead Director
 - ▷ Only Independent/Lead Director
 - ▷ All Board Members
- ▶ What does it cover?
 - ▷ Procedural matters and invitation to meeting
 - ▷ Key business highlights
 - ▷ Key governance highlights
 - ▷ Particular recent developments (comings and goings)
- ▶ Committee specific letters – Compensation Committee

Timelines

- ▶ Evolution of governance enhancements
 - ▷ How does this look next year and each year after?
- ▶ Executive compensation process
- ▶ Director recruitment process
- ▶ Shareholder engagement process
- ▶ Compensation decision process
- ▶ Incentive award lifecycle

Board Skills Matrix

- ▶ NY Comptroller letter and sample skills matrix

Skills	Director 1	Director 2	Director 3	Director 4	Director 5	Director 6	Director 7	Director 8	Director 9	Director 10
Accounting										
Business Development										
Capital Markets										
Company Governance										
Consumer Products										
Corporate Finance										
Energy										
Environmental										
Executive Compensation										
Financial Services										
Healthcare										
Human Resources										
Information Technology										
International										
Legal										
Manufacturing										
Marketing										
Operations										
Public Policy										
Real Estate										
Regulatory										
Risk Management										
Science, Technology, Innovation										
Small Business										
Specialized Skills										
Supply Chain										
Transportation										
Utilities										
Other										

- ▶ Format alternatives:
 - ▷ Identify particular directors/nominees with particular skills/experience
 - ▷ Indicate number of directors/nominees with particular skills/experience (without individual identification)
- ▶ What you say can and will be used against you

Board Composition

- ▶ Percentage of directors who are:
 - ▷ Independence
 - ▷ Diverse (gender and racial/ethnic)
 - ▷ Various tenures
 - ▷ Various ages
 - ▷ Factors noted less often:
 - ▶ CEO experience
 - ▶ Public company board experience
 - ▶ Reside outside of the US

Board Evaluation

- ▶ Process – most common disclosure
 - ▷ Use of questionnaires
 - ▷ Use of third party facilitators
 - ▷ Individual self or peer evaluations
- ▶ Topics
- ▶ Results and findings

The screenshot shows a document with several sections: 'BOARD EVALUATION', 'BOARD EVALUATION', 'BOARD EVALUATION', and 'BOARD EVALUATION'. Below these is a table with columns: 'BOARD EVALUATION', 'BOARD EVALUATION', 'BOARD EVALUATION', and 'BOARD EVALUATION'. The table contains various metrics and data points related to board evaluation.

Director Biographies

- ▶ Add pictures
 - ▷ Can show diversity of board without talking about diversity
- ▶ Avoid all block text biographies
 - ▷ Bullet points to identify changes in positions
 - ▷ Separate disclosure of:
 - ▶ Other board positions
 - ▷ Public versus not public
 - ▶ Skills and experience
 - ▷ Provide easy identification of:
 - ▶ Age
 - ▶ Year director joined board

Shareholder Engagement

- ▶ Possible topics include:
 - ▷ Engagement statistics
 - ▶ How many shareholders
 - ▶ What percentage of shares
 - ▶ Different types of engagement – offered to meet, versus actually met
 - ▶ Participation of management and/or board
 - ▷ Engagement topics
 - ▶ What were primary topics
 - ▶ What was the feedback
 - ▶ What changes (if any) were made
- ▶ Remember, the counterparties to this engagement will be reading this disclosure

Risk Oversight

- ▶ Highlight role of board versus management
- ▶ Identify each committee's and full board's areas of risk oversight



ESG/Social Responsibility Disclosure

- ▶ Possible topics include:
 - ▷ Political contributions/lobbying policies
 - ▷ Health, safety
 - ▷ Social – employment policies
 - ▷ Environment
 - ▷ Sustainability
 - ▷ Community
- ▶ Remember that you have liability for this disclosure
 - ▷ Need to have adequate controls and procedures
 - ▷ Consider forward-looking statements
 - ▷ Boilerplate disclosure probably worse than none

General Observations

- ▶ A picture tells a thousand words – but, just adding a picture (without replacing text) just adds a thousand words
- ▶ Use graphics that you are willing to commit to – year after year, for better or worse
- ▶ Pictures (graphs/charts) can be transparent – sometimes too transparent
 - ▷ Think about all constituents
- ▶ Start early – get buy-in, you may need technical resources

Thanks For Coming!

Good luck with proxy season!
