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# Corporate Governance & Executive Compensation Survey 2021

19<sup>th</sup> Annual Survey of the  
100 Largest U.S. Public Companies

SHEARMAN & STERLING



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# Introduction

Shearman & Sterling is proud to present its 2021 Corporate Governance and Executive Compensation Survey. In last year's Survey, public companies and boards of directors were challenged with a traumatic year of unprecedented events. A global pandemic was raging with no end in sight, and corporate leaders were struggling with how best to respond to social justice protests, recognizing that silence was not an option. A contentious presidential election capped off the year, and it was only in the first months of 2021 that the nation seemed to be returning to a new "normal." With this slow emergence from these difficult times, a number of new corporate imperatives are taking shape and some older ones are getting new attention as a new administration has empowered a new U.S. Securities and Exchange Commission (SEC) with a new direction. These developments are forcing directors and management to reckon with a heightened focus on the place of the corporation in society, and the ability to generate long-term sustainable value creation.

Among the many developments and themes that have emerged in the last twelve months as we slowly emerge from the pandemic, we highlight a few below.

## **DIVERSITY, EQUITY AND INCLUSION**

The social justice movement that emerged during the pandemic in the aftermath of the killing of George Floyd has led to even greater focus by companies, investors, communities and other stakeholders about how to combat systemic racism and other inequities in the workplace. We expect these issues to continue to be a priority for boards and anticipate heightened attention among investors and in the media to actions (or inactions) by public companies designed to increase diversity in board rooms and throughout the organization, address pay equity and compensation disparities and combat racial and other forms of bias and promote inclusion. External factors are also pushing in this direction with the SEC approving a new Nasdaq board diversity disclosure mandate in August and the SEC's regulatory agenda, including new disclosure rules regarding diversity of board members. In addition, there continue to be numerous shareholder proposals focused on board diversity and pay equity, and more companies are adopting "Rooney Rule" type policies for director nominations and disclosing EEO-1 information to increase transparency about pay levels across their organizations.

## **CLIMATE CHANGE AND ENERGY TRANSITION**

With the intensity of the global pandemic slowly receding, climate change issues have returned to front of mind in recent months, punctuated periodically by extreme weather events. The new SEC Chair has announced plans for ambitious new rules requiring mandatory disclosures related to climate change and has made it clear in his public remarks that his objective is to ensure that climate risk disclosures are consistent and comparable, as well as "decision-useful" to investors. At the same time, institutional investors such as Blackrock, who were formerly more circumspect about supporting shareholder proposals on climate change or other environmental topics have now become much more active in their support, buttressing their public statements and policies in emphasizing the need for sustainable long-term growth. In addition, shareholder activists are finding new successes focusing on climate change and environmental issues, the most notable example being activist Engine No. 1's successful proxy battle with Exxon, in which it was able to install three new directors, consisting of a quarter of the board.

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## CYBER SECURITY

Cybersecurity continues to be an important concern for boards and companies as the last twelve months saw an unprecedented level of very public ransomware and cyber attacks against companies and other high-profile targets. The SEC has included potential new rules on cybersecurity risk disclosures in its regulatory agenda and has also formally requested information from numerous companies about cyber incidents, including the well-publicized SolarWinds hack. In the cybersecurity space, the SEC continues to focus on integration of risk management and event response for cyber attacks with a company's disclosure controls and procedures to ensure that investors have a full picture of potential risks and the impact of actual events. In a recent cybersecurity enforcement action discussed later in this Survey, the SEC found a failure in disclosure controls, even in the absence of an actual misstatement or omission. Companies will need to continue to be vigilant about integrating cybersecurity preparedness and response programs with disclosure controls and related matters, such as their insider trading policies.

We hope you enjoy our 2021 Corporate Governance Survey (our 19th Annual). Throughout this Survey, we provide insights on specific topics of interest in the current environment, including practical advice for boards and management. Across all topics our goal is to provide an overview of the current corporate governance landscape and to identify best practices. In addition to the Insights articles, the Survey consists of a review of key governance characteristics of the Top 100 Companies, which we define as the 100 largest companies that have securities listed on the NYSE or Nasdaq, measured by market capitalization and revenue. A list of the Top 100 Companies can be found in "The Survey" section at the end of this publication.

## HUMAN CAPITAL

The global pandemic put new demands on boards to ensure employee safety and wellbeing and balance those critical needs with maintaining the business. The experience of the pandemic has contributed to a new labor shortage in certain industries that will require thoughtful management. The pandemic has also accelerated the pace of change in the workplace, including as a result of remote working, and the development of new paradigms for use of office space and office time and the best ways to collaborate and interact with customers and clients. Companies will need to determine what is right for their workforces and how to get the greatest productivity and commitment from their human capital.

As we move into the second annual report and proxy season with required human capital management (HCM) disclosure, it is clear that this topic will require increased focus and thoughtful disclosure. Human capital is a key source of value for companies and workforce considerations can be critical to shareholders as well. The SEC's HCM disclosure rules currently provide flexibility for issuers, but we have observed trends in the current disclosures reflecting the impact of the COVID-19 global pandemic on workforces, the intersection of social justice concerns and human capital management and discussions around corporate purpose and community involvement. Although HCM disclosure is not required in a proxy statement, a number of companies included enhanced HCM disclosure in their proxy statements in keeping with the increasing importance of the proxy statement as a vehicle for stakeholder engagement efforts, including around environmental, social and governance (ESG) topics such as HCM. The SEC's rulemaking agenda also includes HCM disclosures, which we expect to enhance the existing general disclosure requirement with some of the specific disclosures we saw from companies this year on diversity, training and retention.



## Insights

The focus on environmental, social and governance (ESG) remains a top priority for boards and management as investors and other stakeholders continue to increase the pressure on companies to thoughtfully evaluate and increase transparency on ESG matters.



In the following section we discuss issues that boards and management should consider related to formulating human capital management disclosures, the increased focus on cybersecurity by the SEC, trends we are seeing in shareholder activism, energy transition issues and incorporating ESG metrics into incentive compensation plans. We also share perspectives on corporate governance developments in the United Kingdom.

# The Management and Disclosure of Human Capital Resources Requires a Roadmap

Gillian Emmett Moldowan and Maxmilien Bradley

It is sometimes said that “People are everything.” A company cannot do business without people. Without people, companies cannot open factories, stores or offices. Without people, companies have no employees, customers, suppliers or investors. Despite the rapid growth in automated systems and artificial intelligence, people remain at the core of creation and innovation. The global pandemic served as a reminder of the core role people play in all companies and forced companies to grapple with new challenges in managing this important asset, including employee health and safety, remote work, virtual management, and in certain industries, labor shortages and organized labor activity. But yet, until a year ago, public companies in the United States were obligated to tell their investors very little about the people that work for these companies and enable them to operate and grow. With the introduction of specific human capital resource management disclosure requirements, U.S. public companies have entered into a new dialogue with their investors, employees and regulators regarding the management, retention, support and sustainability of their employees and other human service providers.

<sup>1</sup> Item 101(c)(2)(ii) of Regulation S-K requires that companies “[d]iscuss the information specified [below] with respect to, and to the extent material to an understanding of, the registrant’s business taken as a whole, except that, if the information is material to a particular segment, you should additionally identify that segment... A description of the registrant’s human capital resources, including the number of persons employed by the registrant, and any human capital measures or objectives that the registrant focuses on in managing the business (such as depending on the nature of the registrant’s business and workforce, measures or objectives that address the development, attraction and retention of personnel).”

<sup>2</sup> Under Item 402 of Regulation S-K, companies have been required to describe in great detail the compensation of their named executive officers (a group consisting of specified executive officers as dictated by the disclosure rules). This is important information but, because of its limited scope, does not necessarily shed light on the management of the much larger employee population. It should also be noted that companies have been required to disclose certain information relating to employees to the extent it directly impacts financial statements (for instance, valuation and liability matters with respect to pension plans) and, further, some companies have been providing voluntary disclosure of human capital matters to varying degrees in corporate social responsibility reports and other publications, including their websites.

## WHERE WE WERE

Prior to the adoption by the SEC in August 2020 of specific disclosure requirements under Regulation S-K regarding human capital resource management,<sup>1</sup> the only employee-focused disclosure required in describing a company’s business was to indicate the total number of persons employed by the company.<sup>2</sup> Although some companies would provide voluntary disclosures on information, such as employee location and the use of unionized workforces, this disclosure was neither consistent across companies nor generally robust. Investors and other stakeholders could thus tell how many people worked for a company, and perhaps where such individuals were located, but not how the management of employees (or even the number of employees) fit into the business objectives and strategies of the company. It was as if you knew how many people lived in your neighborhood, but not who they were, what they did, their backgrounds or whether they were safe, happy or wanted to be there. With such limited numerical information, would you have the material information to understand your neighborhood?

The perspective that broader workforce policies, practices and strategies are material to shareholders has been an area of ongoing discussion. With the introduction of specific human capital resource management disclosure, public companies in the United States, including foreign private issuers, are now required to disclose, to the extent material to an understanding of the company’s business taken as a whole, the company’s human capital resources, including the number of employees and any human capital measures or objectives that the company focuses on in managing the business. This rule requires companies to determine for themselves the human capital resources, measures and objectives that are material to their business. This is a difficult task. First, companies have not been required previously to make this assessment for disclosure purposes. Further, each company may determine a different set of issues that are material to its human capital management, making it difficult to benchmark against peers.

With a year of public disclosures responding to the new human capital resource management disclosure rule available for review, have we learned anything about what aspects of human capital are material to U.S. public companies? One striking feature of disclosures thus far is their range with respect to detail. Some companies have included no more than a paragraph, hardly more than what was provided under the prior rule. On the other hand, some companies have included many pages of disclosure, which in some cases refer to even more information provided in other reports on corporate social responsibility, diversity or human capital management. What should we glean from this range? Are people material to these companies in different ways? Perhaps. **But the range may tell us more about which companies had systems in place that could**

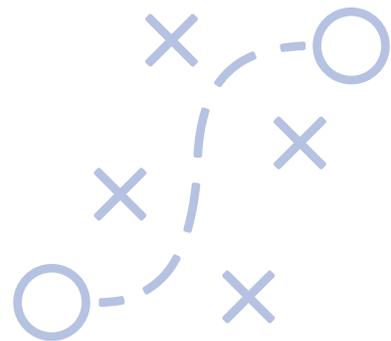
**be leveraged to respond to the new disclosure rule than it does about the relative importance of people to their business.** Such systems include existing human capital management data and measurement tracking tools, already established executive teams and board committees responsible for human capital management development and oversight and employees and advisors in place and ready to translate this information into meaningful human capital resource management disclosures. In the first year of required disclosure, many companies were likely unprepared for the new rule. As we move into the second year of mandated disclosure, companies should increase their readiness for comprehensive and effective human capital resource management disclosure. Our suggestions for this preparation are below.

## WHERE WE ARE NOW

A review of human capital resource management disclosures by the Top 100 Companies is instructive. The Top 100 Companies focused on a relatively consistent range of topics in their disclosures, with certain topics heavily emphasized. By far, workforce demographics and diversity and inclusion were the most discussed topics. Employee health and safety was also a leader. Relatedly, a significant number of the Top 100 Companies described their response to the COVID-19 pandemic as it related to employees. Other topics addressed include the general compensation structure applicable to the broad-based employee population, employee benefit offerings, information with respect to employee surveys and other measures of employee engagement, employee training and development and the executives and board committees that are responsible for human capital management and oversight.

Disclosures by the Top 100 Companies were largely qualitative, not quantitative.<sup>3</sup> Despite this, quantitative data was provided. Nearly all of the Top 100 Companies provided the total number of employees. Beyond that measurement, the leading topics where quantitative measurements were disclosed by the Top 100 Companies are set forth on the following page (for a listing of the most discussed topics, whether qualitative or quantitative, see page 44):

<sup>3</sup> This is of particular interest because in connection with the adoption of the new disclosure rule, former-SEC Chairman Jay Clayton underscored the fact that the new disclosure rule is principles-based, but also noted that he did “expect to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs” and that “as is the case with non-GAAP financial measures, [he] would also expect companies to maintain metric definitions constant from period to period or to disclose prominently any changes to the metrics used or the definition of those metrics.”



## Quantitative Disclosures

Topic	Percentage of Top 100 Companies Disclosing an Associated Measurement	Measurement Example
Employee Work Location	55%	Number of employees by country
<b>Employment Classifications</b> Including Full-Time Employees, Part-Time Employees and Independent Contractors	37%	Number of full-time employees versus number of part-time employees
Employee Gender	36%	Percentage of employee population by gender
Employee Race or Ethnicity	33%	Percentage of employee population by race or ethnicity
Collective Bargaining Agreements	20%	Percentage of employees covered by collective bargaining agreements
Employee Feedback	18%	Percentage of employees responding to employee surveys
Employee Turnover	15%	Annual turnover rate
Professional Development	15%	Number of employees participating in training programs
Business Department or Division	15%	Number of employees by division

In addition to reviewing human capital resource disclosures, a review of SEC staff comments to those disclosures is insightful. It is important to understand that the SEC staff is commenting on human capital resource disclosures it views as deficient. Thus far, comments have largely come in circumstances where registration statements have provided no or very minimal human capital resource management disclosure. However, the SEC staff has also asked companies to expand human capital resource management disclosure in registration statements, in particular where the disclosure appeared to be responsive only to the prior rule under Regulation S-K to disclose the number of employees of the issuer (i.e., the disclosure focused almost exclusively on the total number of employees, geographic breakdown of employees, or whether employees were members of a union). These SEC staff comments included a specific

reference to the requirement to disclose, in addition to human capital *resources*, human capital *measures* or *objectives* the issuer focuses on in managing the business. Companies should be reminded of this language from the new human capital resource management disclosure rule — the new rule is intended to get not just the who, but also the why, of human capital resource management.

We expect these comments are only the starting point, and that the SEC staff will expand its review and comment on human capital resource management disclosures in annual reports, as well as comment both in registration statements and annual reports on matters beyond simple compliance, such as requesting that companies provide specific programmatic or data-driven support for statements that are considered to be too general or unsubstantiated. Draft disclosures should be reviewed carefully to determine that they address the totality of the disclosure rule.

### Examples of SEC Staff Comments

1

Please amend your disclosure to provide a more detailed discussion of your human capital resources, including any human capital measures or objectives upon which you focus in managing your business. For example, describe any measures or objectives that address the development, attraction and retention of personnel.

2

Please amend your disclosure to describe any human capital measures or objectives you focus on in managing your business, if material.

3

Please revise to provide a description of your human capital resources, if material, as required by Item 101(c)(2)(ii) of Regulation S-K. Disclose the number of contractors and consultants that you employ.

4

We note the disclosure in this section that currently none of your employees are covered by collective bargaining agreements or represented by labor unions. Please reconcile with the disclosure in the risk factor on page 54 that you currently have employees represented by unions.

### Examples of Changes Made in Issuer's Revised Filing Following SEC Staff Comment

1

Adding "Human Capital Resources" to section title. We note that although seemingly a minor change, this signals an intentional responsiveness to the new disclosure rule. We recommend companies ensure that the title of the relevant section no longer go under its former heading of "Employees" but be amended to include terminology signaling new human capital resource management disclosure.

2

Adding the language "Our human capital resources objectives include, as applicable, identifying, recruiting, retaining, incentivizing and integrating our existing and prospective employees."

## WHERE WE ARE GOING AND HOW DO WE GET THERE

With the information able to be gleaned from a year of disclosure under the new rule, how should companies approach crafting human capital resource management disclosure that meets the obligations of the rule and helps stakeholders understand how this critical asset is managed?

### Form a Team

Companies need a system in place to tackle this disclosure — a system of people to manage and oversee human capital resources and data collection and analysis. The individuals that are responsible for managing human capital resources are crucial to the process of preparing meaningful disclosure. These individuals should be identified and integrated into the disclosure preparation process. Companies should also determine how the human capital management team will address human capital matters with the company's board. Boards, together with management, should decide how the board will oversee human capital management issues, specifically, whether these matters will be brought in the first instance to the full board or a committee of the board. Companies are increasingly placing human capital management oversight responsibility with the board's compensation committee (which some companies have renamed the human capital management committee or similar) or the nomination and governance committee (often in the case of companies that are approaching human capital management as an integrated aspect of comprehensive ESG oversight). Keep in mind that new approaches to human capital management oversight may require changes to corporate governance guidelines or committee charters, as well as appropriately updating company websites to reflect such adjustments.

#### Questions to consider:

Who in the organization is responsible for managing our human capital resources? Is it a chief human resources officer? Is it a shared role between an executive and the general counsel's office? Should the team include outside advisors, from a legal and consultancy perspective, to advise on human capital management, much like the role advisors have historically played in the context of executive compensation?

## Set Measurable Human Capital Management Objectives

Companies should develop clear human capital management measurements and objectives and share and discuss these objectives with their boards. Human capital resource management disclosure should describe the aspects of human capital resources the company measures, why those measures are tracked and what goals the company has with respect to those measures. Disclosure should address whether the company has met its objectives and, if not yet met, where the company is on its path to achievement. It is helpful to include specific data points and describe programs that the company has implemented to achieve its objectives. Companies should also expect to be held accountable for progress toward their goals and should be careful not to promise the achievement of unrealistic goals. Further, if goals are being revisited and revised, companies should discuss why these adjustments have occurred. In order to make these disclosures, companies will need to determine what it means to attain specified goals, especially for broader goals, and how to track progress.

#### Questions to consider:

What is the company's philosophy with respect to human capital resource management? How do the measures presented contribute to a cohesive approach? What is the company going to do differently in the coming year if goals have not been achieved? How will the company consider what it did last year and whether that approach is still right for the company?

## Identify Business Priorities and Strategies

Companies, together with their boards, need to assess human capital management specifically in the context of the company's business plan and priorities. It is key to meaningful human capital resource management disclosure to not just describe the company's human capital resources, measures and objectives, but to situate these into a description of the company's long-term objectives and strategies. After reviewing a company's human capital resource management disclosure, shareholders and other readers should be able to discern how the company's employees and approach to employee engagement progress and support the company's business plan. The focus of the disclosure is rooted in an explanation of the company's business and how people, as a critical asset of the business, are managed in that framework.

### Questions to consider:

How does the company support its people to achieve business objectives? As business objectives and strategies evolve, for instance in response to particular changes raised by the global pandemic, how does human capital resource management and measurement evolve in response? Does the company provide training and development opportunities for its employees to further the company's business plan? How does employee recruitment and talent retention factor into the achievement of long-term goals? What does the company do to promote the health and safety of employees, and how does that align with a sustainable company? Are compensation programs designed with specific business plan objectives in mind?



## THE ROADMAP

By forming a team, setting measurable human capital management objectives and identifying business priorities and strategies to situate those human capital management objectives, companies can set out a roadmap for drafting effective human capital resource management disclosure and continuing to develop the systems behind human capital management itself. Oversight and accountability are the watchwords to consider as human capital resource management disclosure develops. The board (or an identified committee) should be fully engaged in the development of human capital management priorities to ensure continued alignment with strategic planning and enterprise risk management. Disclosures should be reviewed by the board (or an identified committee), reflective of the company's business and supported with specific data and actions, coordinated with other information presented by the company (such as in corporate social responsibility reports) and monitored year-over-year with a view toward the company's growth and development in this area over time.

### What's Down the Road

Further human capital resource management disclosure rules, in particular rules mandating specific quantitative disclosures or consistent metrics across industries, may be coming. On June 23, 2021, SEC Chair Gary Gensler, in prepared remarks addressing "key areas of the reform agenda" at the SEC, noted that he asked SEC staff to put together recommendations for further mandatory company disclosures on human capital. Gensler explained that this "could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics, including diversity, and health and safety." A requirement to disclose specific human capital measurements would represent a significant shift from the current principles-based rule. The need for companies to adjust to this shift and the potential for further human capital resource management disclosure rules may make the strategies and roadmap discussed in this article all the more important.

# The SEC Double-Clicks on Cybersecurity

Lona Nallengara and Richard B. Alsop

Although the focus of many public company boards as they look forward into 2022 will be on how to assess, measure and talk about climate risks and opportunities, human capital issues and ESG more generally, boards and management should not lose sight of the importance of cybersecurity risk. Board attention to cybersecurity matters has been steadily increasing over the past five years to the point where today nearly all of the Top 100 Companies identify cybersecurity matters as a key board responsibility and as part of the board's oversight of risk management, compared to about 60% of the Top 100 Companies in 2017. Corporate boards are not alone in their focus on cybersecurity. The SEC over the last few years has increasingly been flexing its muscles in cybersecurity matters, and recent actions suggest that management and boards should be paying attention.

A few short years ago, the focus of the SEC was largely whether risk factor disclosures adequately and completely presented the cybersecurity risks a public company was facing. Applicable SEC interpretative guidance indicated that adequate risk disclosure required reasonable specificity and, in particular, whether the company had actually experienced the risk that was identified. The SEC made it clear that it was not enough to say a cyberattack could happen; investors needed to know whether one had already happened. This disclosure requirement remains, but the expectations with respect to what a company says and does when a cyberattack occurs and what management and the board have done leading up to the attack are increasingly coming under SEC scrutiny.

## Interpretive Guidance

In February 2018, the SEC released new interpretive guidance on public company disclosures regarding cybersecurity risks and incidents, which outlined the SEC's views regarding disclosures by public companies relating to cybersecurity risks, events and incidents under existing securities laws. The interpretive guidance provided a useful framework for thinking about the various areas where cybersecurity-related disclosures may need to be made, such as risk factors, business description, MD&A, legal proceedings and financial statement disclosures. More importantly, the interpretive guidance outlined, for the first time, the SEC view that:

- Public companies should be describing the role that boards of directors have in cybersecurity-related risk management to the extent those risks are material to their businesses;
- Public companies should maintain adequate disclosure controls and procedures so that those individuals responsible for disclosures are promptly alerted of cybersecurity incidents and a timely materiality and disclosure assessment can be made; and
- Public companies should have policies and procedures that restrict the ability of officers, directors and other insiders from trading before a decision has been made regarding the materiality of and disclosure related to a cyber incident.

## The SEC's First Cyber Disclosure Case

In April 2018, the SEC brought a case against Yahoo! for failing to disclose a data breach that compromised the personal data of millions of users. The SEC order stated that Yahoo! failed to disclose the existence of the data breach and its potential business impact and legal implications in periodic filings, instead including only general statements about the potential risk from cybersecurity attacks and incidents. This was the first cybersecurity disclosure case, and it goes to the heart of the interpretive guidance issued by the SEC. The first version of the SEC's cybersecurity guidance was issued in 2011, and the SEC limited "enforcement" of the guidance to issuing comment letters that pushed companies to rethink cybersecurity disclosures. Bringing a case focused on inadequate cybersecurity disclosures demonstrated the SEC's increasing concern about the potential risks and impacts of cyber attacks and its sense that investor protection demanded more robust, timely and specific disclosures. The SEC also found a failure of Yahoo!'s disclosure controls and procedures due to the fact that the existence and risk of cybersecurity breaches were not properly and timely reviewed by those responsible for making disclosure decisions, which reflected a timely reinforcement of the February 2018 interpretive guidance.

## Cybersecurity and Internal Controls

In October 2018, the SEC issued a report outlining an investigation of a number of companies focused on a series of "business email compromises." Each of the companies included as part of the report received spoofed electronic communications purporting to originate from a company executive or vendor, which triggered the companies to transfer large sums or pay falsified invoices to accounts controlled by the perpetrators of the scheme. In the investigation, the SEC considered whether the companies violated federal securities laws by failing to have sufficient internal accounting controls. Public companies are required to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are executed with, or that access to company assets is permitted only with, management's general or specific authorization. As part of its report, the SEC made it clear that public companies "must calibrate their internal accounting controls to the current risk environment and assess and adjust policies and procedures accordingly" and that "all public companies have obligations to maintain sufficient internal accounting controls and should consider cyber threats when fulfilling those obligations."

## WHAT THE SEC IS DOING NOW?

### New SEC Rules Coming

Currently, there is no affirmative obligation mandating specific disclosure requirements related to cybersecurity, so the SEC, as described above, has used existing disclosure obligations, like risk factors and board oversight of risk, and general concepts of materiality as a basis to assert to public companies that cybersecurity should be addressed as part of these disclosures. There have, however, been calls for specific disclosure requirements, including from Congress.<sup>1</sup> The SEC, in the past, has relied on interpretive guidance as the basis to encourage companies to disclose information about the actual and possible cybersecurity risks faced and how they think about managing the risk. For some, the weakness of the guidance is simply that it is just guidance. Although most companies take SEC disclosure guidance seriously, without a clear disclosure requirement, the concern is that companies can craft their own disclosures, and investors are not provided with consistent disclosure. Investors cannot easily evaluate cyber-preparedness and risk management across public companies. As the frequency and scope of the cybersecurity attacks have increased, the calls for action by the SEC have grown. There are, however, limits as to what the SEC can mandate from a public company, which is largely bounded by requiring disclosures related to cybersecurity and using enforcement tools focused on disclosures and internal controls to drive focus on cybersecurity matters.

The SEC has announced that it expects to propose new rule amendments to "enhance issuer disclosures regarding cybersecurity risk governance." Although we do not know exactly what that means, we expect that the rule will ask companies to affirmatively discuss how management addresses cybersecurity and how cybersecurity risk is addressed in the board's overall assessment of risk management. The new rule could also require a discussion



<sup>1</sup> There have been a number of pieces of legislation that have been introduced in the House of Representatives and the Senate over the last few years seeking to direct the SEC to adopt rules related to cybersecurity disclosures. For example, *S. 808 – Cybersecurity Disclosure Act of 2021*, which would require the SEC to adopt rules that would mandate disclosure in the proxy statement regarding the expertise on the board related to cybersecurity.

of whether cybersecurity knowledge or experience is a skillset that is present on the board and/or whether the attribute is one for which the board looks for in new directors. In both cases, the rule could ask companies to disclose its approach to risk management and board composition, or explain why it has not considered cybersecurity in these two areas. Disclosure of cybersecurity risk management has been a consideration in proxy disclosures for some time. Although cybersecurity expertise is increasingly being cited as a factor in consideration of new director candidates, it has not been broadly adopted. If the rule mandates a discussion of cybersecurity experience in the proxy statement, many companies will be forced to consider it. For some companies, making a statement that its board does not need a person with cybersecurity expertise may not be palatable.

### Enforcement

The SEC has stepped up its enforcement efforts in the cybersecurity area following the actions in 2018. Two cases in 2021, *First American* and *Pearson* signal a change in the approach the SEC is taking to cybersecurity enforcement. In the *First American* matter, First American suffered a cybersecurity attack, which compromised confidential, personal client information, but its information security personnel did not follow First American's escalation procedures, which resulted in a failure to inform the senior management responsible for disclosure of the incident until months after the attack. The SEC found that First American had deficient disclosure controls and procedures because there were not processes and procedures that would have resulted in individuals responsible for disclosure being informed of cybersecurity events to determine whether disclosure was necessary. What was interesting in this case was that the SEC did not find that First American had a disclosure violation. Unlike the *Yahoo!* case, where the SEC determined that Yahoo! omitted material disclosures in its periodic filings related to the cybersecurity events, the SEC's order against First American found a controls deficiency despite the absence of a finding of any misstatement or omission.

In the *Pearson* matter, Pearson suffered a cybersecurity attack that resulted in a compromise of sensitive customer data. The SEC found that the statements that Pearson made about the cybersecurity incident after it occurred were misleading and omitted important information. For example, the SEC found that Pearson referred to a data privacy attack as a hypothetical risk in public reporting after the incident occurred but before it made public disclosure of the attack. Additionally, the SEC found that Pearson's statements after it announced the incident did not disclose the full scope of the types of customer information that was compromised. These findings are not unusual. They draw directly from the cybersecurity interpretive guidance and the comment letters issued by the SEC over the last several years. The SEC, however, also found that statements made by Pearson relating to the quality of its security protections were also misleading. In its public statements announcing the incident, Pearson said, "Protecting our customers' information is of critical importance to us. We have strict data protections in place and have reviewed this incident, found and fixed the vulnerability." These statements appear to be exactly what many companies would want to say when trying to weather the fallout from a cybersecurity attack, particularly one that involves the exposure of personal data of customers. Many companies try to reassure their customers, business partners and shareholders that they have things under control. The SEC concluded, however, in Pearson's case, that these statements were misleading.



## WHAT SHOULD THE BOARD AND MANAGEMENT BE DOING NOW?

### Review Periodic Disclosures

Most companies have heard the SEC on disclosure and know what the SEC expects companies to describe related to cybersecurity risks, the costs associated with prevention and the possibility of a cybersecurity event happening. No company should be expected to provide the details of any cybersecurity event to the extent that it becomes vulnerable to new attacks, but the SEC expects transparency about a company's cybersecurity history. Disclosure about hypothetical risks when the risk has happened is a ripe target for review and potential enforcement by the SEC. With the renewed focus on cybersecurity, it is advisable to review disclosures now.

### Disclosure Controls and Procedures

The recent SEC enforcement actions reaffirm the importance of ensuring that a company's disclosure committee is directly connected to those responsible for evaluating and reporting on cybersecurity risks, incidents and events. The escalation procedures within a company's information security department should be reviewed to ensure that they require reporting to a disclosure committee representative when incidents occur and on an ongoing basis as the scope and cause of the incident is investigated and understood. Companies should train and test to make sure this information sharing is happening. The SEC has made it clear that establishing these processes and procedures is important.

### Take Care When Disclosing the Occurrence of a Cyber Incident

The recent *Pearson* matter makes it clear that the SEC will scrutinize more than just the timing of disclosures related to a cybersecurity incident. The SEC will also look closely at what a company says about an actual cyberattack to ensure that it is not misstating or omitting material information. There will likely be strong pressure from a number of internal stakeholders to downplay the incident by limiting the description of what happened, including, for example, the extent of the data that may have been compromised, and to use strong words to reassure investors, customers, business partners and employees that the company has robust cybersecurity controls in place. Be aware that the SEC is reading these statements too. The SEC may take the view that an overly assertive statement about the rigor of existing cybersecurity protections may be inconsistent with the occurrence of the event in question.

### Cyber Expertise on the Board

Consider how the company will respond if the SEC mandates disclosure related to the cybersecurity expertise on the board. The anticipated rulemaking from the SEC will likely propose a disclosure requirement in the proxy statement that asks companies to disclose what board committee oversees cybersecurity and whether the board has cybersecurity expertise and, if not, how the board obtains this expertise. For some companies, affirmatively disclosing that the board does not have or is not seeking to add this expertise may not be practical.

### Insider Trading

Review your insider trading policy to ensure that cybersecurity incidents are specifically identified. Additionally, ensure that a process is in place whereby those with the responsibility for establishing trading blackout periods are promptly informed of the occurrence of a cybersecurity event or incident.



# Recent Shareholder Activism Trends

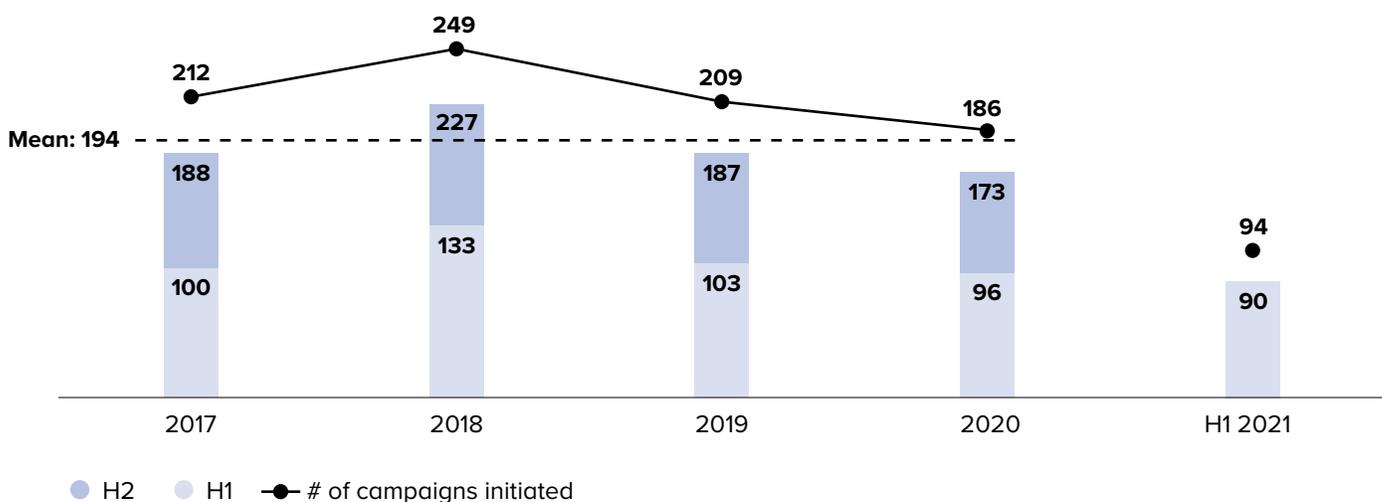
George A. Casey, Scott D. Petepiece, Lara Aryani and Vita Zhu

After years of growth in shareholder activist activity, the onset of COVID-19 across the world caused a decline in shareholder activism campaigns in the spring and summer of 2020. Economic recovery in the second half of the year coincided with the end-of-year proxy season and gave rise to a renewed appetite for activist campaigns in Q4 that continued through the first half of 2021. While uncertainty remains, particularly on a regional basis due to variations in vaccination rates and the impact of new variants of COVID-19, we expect to see renewed vigor in shareholder activism to continue through the second half of 2021 and into 2022.

## SHAREHOLDER ACTIVISM IN 2020

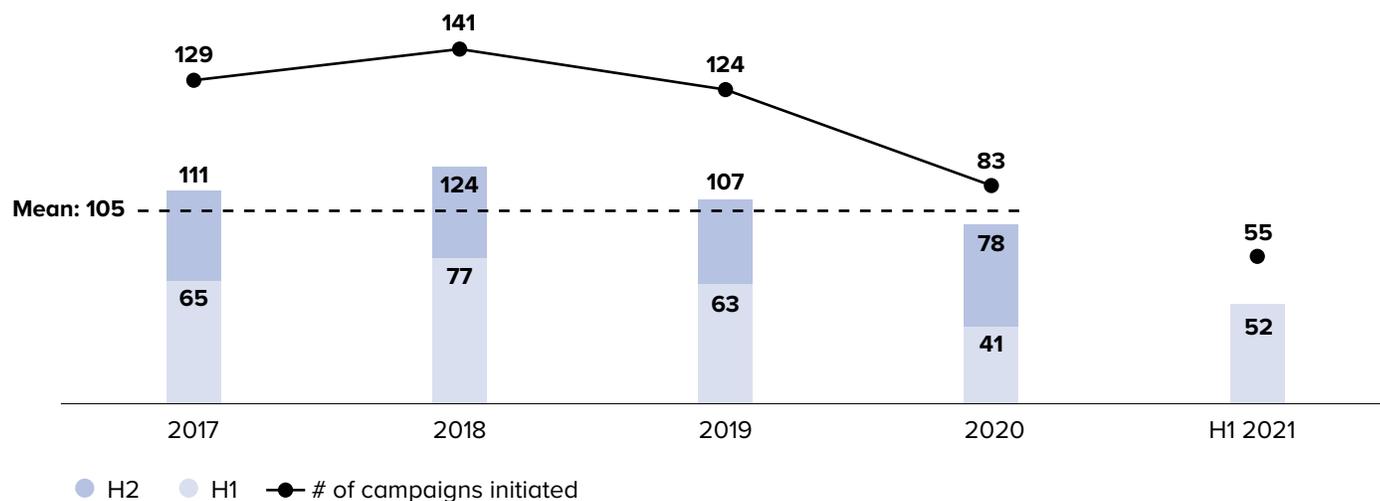
While shareholder activism declined sharply in the spring and summer of 2020, the overall number of campaigns was lower but did not result in a significant year-over-year decline. This was in large part due to the fact that the two annual proxy seasons book-ended the market turbulence of 2020, such that many of the activist campaigns were initiated either before COVID-19 in Q2 or after the economic recovery at the end of the year. The rebound of activism continued through the first half of 2021, with activist campaigns in the U.S. accelerating at a higher pace — large-cap United States companies experienced an approximately 30% increase in the number of activist campaigns in the first half of 2021 compared to 2020 (see chart below). Notwithstanding this renewed push, activism levels remain muted compared to the 2017–2020 averages (see chart below). Nevertheless, we expect the growing momentum to continue into the second half of 2021 and into 2022.

### Global Annual Campaign Activity



Source: Lazard, *H1 2021 Review of Shareholder Activism*, <https://www.lazard.com/media/451731/lazards-h1-2021-review-of-shareholder-activism-vff.pdf>.

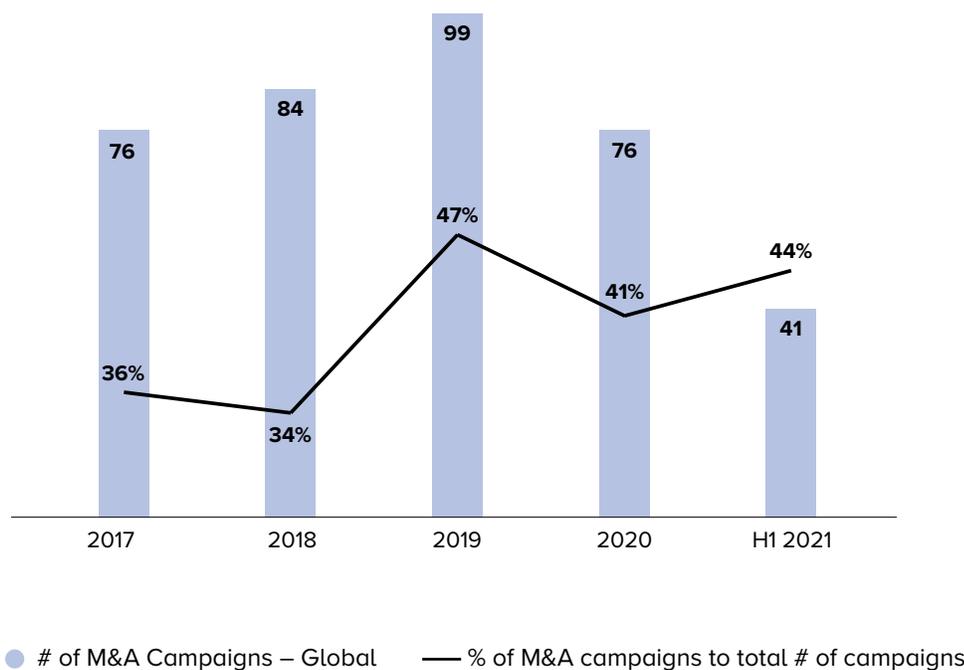
## U.S. Annual Campaign Activity



Source: Lazard, *H1 2021 Review of Shareholder Activism*, <https://www.lazard.com/media/451731/lazards-h1-2021-review-of-shareholder-activism-vff.pdf>.

## M&A-RELATED ACTIVISM REMAINS IN FOCUS

M&A-related activist campaigns remain the most common campaigns in 2020 and in the first half of 2021, constituting 41% and 44% of the total campaigns initiated at large-cap companies during such periods, respectively, consistent with levels of recent years.



Source: Lazard, *H1 2021 Review of Shareholder Activism*, <https://www.lazard.com/media/451731/lazards-h1-2021-review-of-shareholder-activism-vff.pdf>.

## ESG ACTIVISM CONTINUES TO RISE

### ESG-themed or ESG-related campaigns are trending

Activists launched multiple ESG-themed campaigns in 2020 and early 2021, with environmental issues standing front and center. In 2020, London-based hedge fund BlueBell Capital Partners announced its “One Share ESG Campaign” whereby it buys one share of a company that it believes has questionable ESG practices, and later that year it targeted Belgian chemicals company Solvay to demand it cease discharging waste from its Tuscany plant into the sea. In early 2020, another London-based hedge fund, The Children’s Investment Fund (TCI), launched its “Say on Climate” campaign (modeled after the “Say on Pay” executive compensation initiative), which has resulted in more than 20 companies, including Unilever, Moody’s, Canadian National Railway, Rio Tinto, S&P Global and the Spanish airports operator Aena, committing to hold Say on Climate votes.<sup>1</sup> Perhaps the most notable ESG activist victory thus far was the recently formed ESG-focused activist fund Engine No. 1’s successful campaign to elect three directors to the board of ExxonMobil in a bid to push the company toward transitioning to a low-carbon economy. The campaign received significant institutional investor support, including from Vanguard, BlackRock, State Street, T. Rowe Price and CalPERS, as well as support from Institutional Shareholder Services (ISS) and Glass Lewis. Even shareholder activists that have historically not focused on ESG matters are now integrating ESG issues into their campaigns. After pushing for what was an unsuccessful sale of the utility company Evergy, activist firm Elliott settled its campaign when Evergy agreed to a five-year business plan that included the adoption of a sustainability transformation plan and a shift toward renewable energy. In its successful campaign to force the multinational insurer Prudential to separate its U.S. business and its Asia business, hedge fund Third Point argued that the divestment would save costs and reduce the company’s carbon footprint. While the activists pivoting to ESG is likely opportunistic rather than a shift away from maximizing shareholder returns, it does show that they believe that ESG may help draw support from large institutional investors, which have been more vocal about their willingness to support ESG-driven activist campaigns, and other stakeholders such as ISS and Glass Lewis.

<sup>1</sup> See Say On Climate, <https://sayonclimate.org/supporters>.

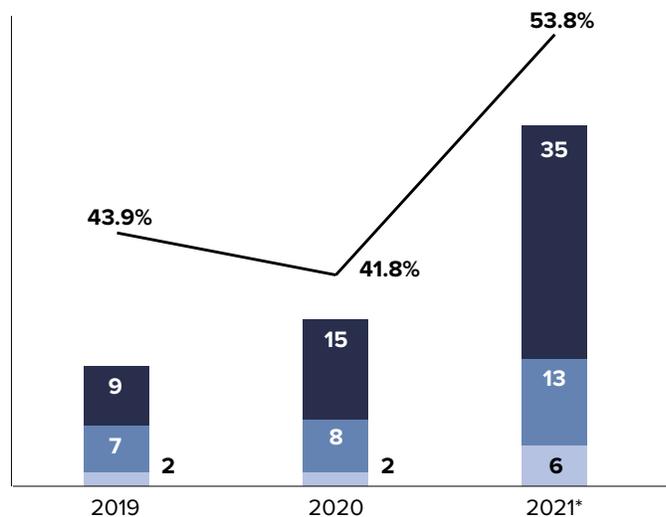
<sup>2</sup> Note that some socially or environmentally focused campaigns occurred primarily outside of the proxy ballot. The campaign spearheaded by the New York City Comptroller’s Office seeking public disclosure of the S&P 100 companies’ Employment Information Report (EEO-1, which provides a demographic breakdown of an employer’s work force by race and gender) data and the non-profit shareholder advocacy group, As You Sow’s engagement with companies asking for net zero transition plans with shareholder voting both fall under this category.

<sup>3</sup> Source: Deal Point Data. Proposals are limited to Rule 14a-8 proposals for meetings during the relevant period and for 2021, with a proposal proxy filing date on or before August 31, 2021.

### Environmental and social (E&S) proposals gain more support<sup>2</sup>

While the number of social and political proposals in 2021 remains comparable with prior years, they are garnering more support among shareholders. Nearly 20% of the social and political proposals voted on received majority shareholder support, up from approximately 10% in 2020 and 7% in 2019. All social and political proposals voted on received an average support of 34.4%, up from 27.7% in 2020 and 28.1% in 2019. Among the social proposals, those relating to racial equity reporting received a record number of submissions (eight submissions), and those related to workforce diversity increased dramatically (more than doubled the 2020 submissions and quadrupled the 2019 submissions).<sup>3</sup>

### Workforce Diversity Proposals

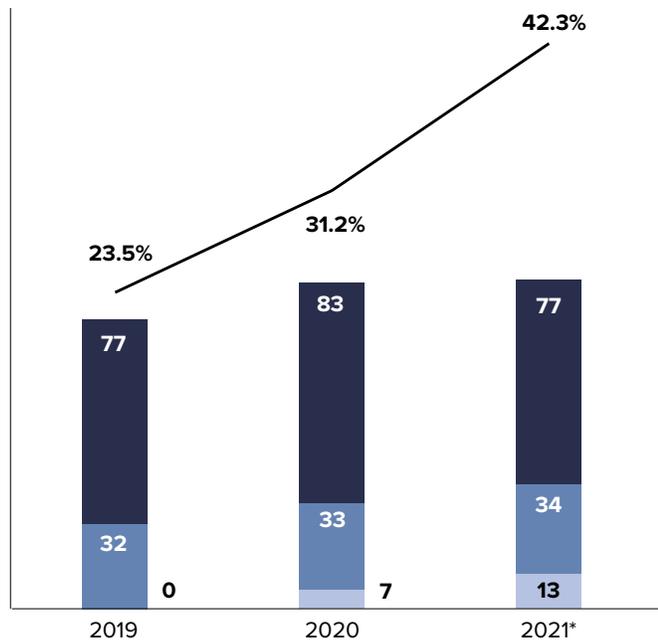


- Total Proposals
- Voted On
- Received Majority Vote
- % of For

\*All workforce diversity proposals for meetings between January 1, 2021, and December 31, 2021, with a proposal proxy filing date on or before August 31, 2021.

Environmental proposals are also receiving more support from shareholders in the 2021 proxy season. Approximately 38% of all environmental proposals that were voted on this year received majority shareholder support, compared to none in 2019 and about 21% in 2020. The average support for all environmental proposals voted on also increased (by more than 10% compared to 2020).<sup>4</sup>

### Environmental Proposals



- Total Proposals
- Voted On
- Received Majority Vote
- % of For

\*All environmental proposals for meetings between January 1, 2021, and December 31, 2021, with a proposal proxy filing date on or before August 31, 2021.

We expect to see activists continuing to pivot to ESG issues in their campaigns and that companies that are both behind on ESG issues and financial underperformers will be more vulnerable to activist campaigns. We also expect shareholders to continue to engage on E&S issues inside and outside of the proxy ballot. It remains to be seen at what pace ESG-focused activist funds will grow or whether ESG issues will become a primary campaign objective given the perceived tension between the ESG-themed impact investing strategy and the conventional activist objectives of maximizing shareholder returns.

<sup>4</sup> Source: Deal Point Data. Proposals are limited to Rule 14a-8 proposals for meetings during the relevant period and for 2021, with a proposal proxy filing date on or before August 31, 2021.

## CONVERGENCE OF ACTIVISTS AND PRIVATE EQUITY

The convergence of activist investing and private equity persisted throughout the COVID-19 pandemic:

### Activists pursuing new pool of capital and engaging in acquisitions

Several activist funds, including Hudson Executive Capital, Pershing Square, Starboard Value and Elliott, found new avenues for raising capital during the SPAC frenzy of 2020–2021, and have deployed capital raised in SPAC IPOs to engage in heightened M&A activity. Activist investors are also finding inroads into new publicly listed companies by participating in PIPE investments associated with many of the de-SPAC transactions, alongside private equity firms (e.g., ValueAct’s investment in the EV maker Nikola and Inclusive Capital’s investment in AppHarvest, an agriculture technology company). Certain activists are also turning to what was once known as private equity turf — privately held companies — in an attempt to seek the lucrative gains enjoyed by private equity in these investments and gain access to additional information that can help inform other investment decisions.

### Private equity deploying activist tactics

Private equity firms continue to make activist-like moves, including by amassing ownership stakes in public companies, engaging more actively with management and running proxy fights. KKR acquired a 10.7% stake in the restaurant and entertainment company Dave & Buster’s in early 2020 and signaled a desire to engage with the board or management and to seek board or management changes, or a possible transaction. KKR later secured a seat on Dave & Buster’s board. In September 2020, New Mountain Vantage Advisers (NMV), holding approximately 10.8% of the common stock of the IT services company Virtusa, launched a campaign against Virtusa calling for immediate board change at Virtusa to drive what it described as long-overdue corporate governance reform and management accountability. NMV and Virtusa reached an agreement in October in connection with NMV’s nominations for directors.

### Activists and private equity teaming up

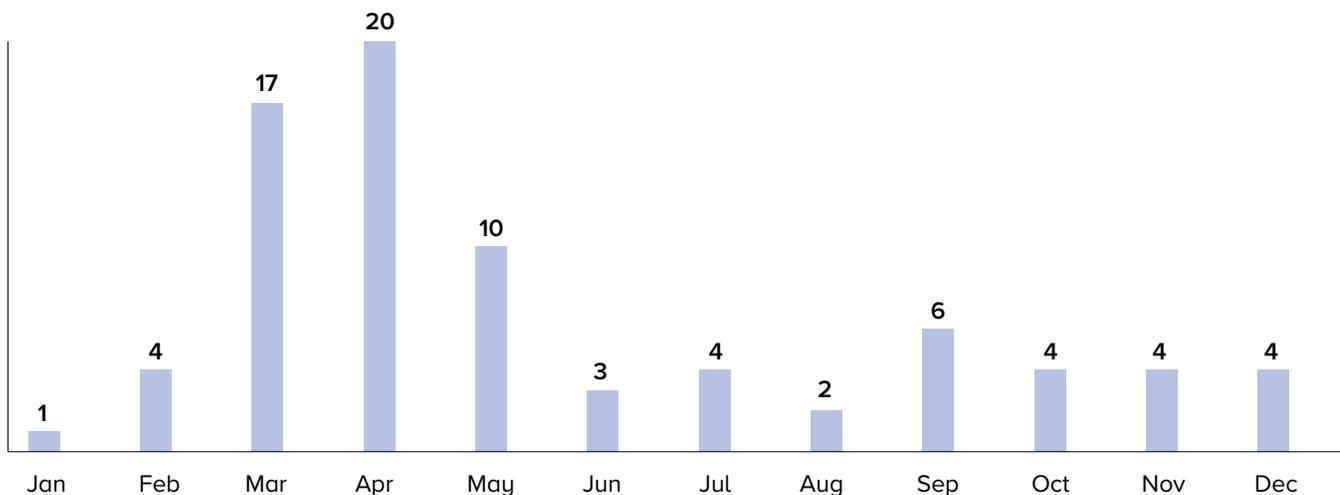
While activists and private equity investors have continued to borrow from each other’s toolboxes, they have also increasingly teamed up on strategic campaigns. Hedge fund Senator Investment Group joined Cannae Holdings in a buyout offer of the property data company CoreLogic, and Hudson Executive Capital joined private equity firm Apollo Global Management in a buyout offer for the ATM operator Cardtronics, while Elliott pursued a takeover of the public transportation and defense company Cubic with private equity firm Veritas Capital and worked with frequent ally Bluescape Resources against Evergy, the utility company.

The convergence of activists and private equity is the outcome of multiple factors: the intense competition for positive returns, both investment classes sharing similar sensibilities for undervalued companies (including a willingness to drive certain operational, financial and strategic efficiencies) and the record amounts of capital raised but undeployed on hand. While we expect some continued cooperation between activists and private equity, restrictions in private equity limited partnership agreements on hostile transactions and proxy fights and negative associations with activist activities may subdue cooperation on activist campaigns.



### POISON PILLS SURGED IN 2020 BUT NORMALIZED IN 2021

Market volatility in the early days of the COVID-19 pandemic provided activists with an opportunity to take advantage of the unprecedented drop in stock prices in March, which led to a significant uptick in the adoption of anti-takeover rights plans. About three times as many rights plans (79) were adopted in 2020 by companies listed in the United States compared to historical numbers (22 in 2018 and 23 in 2019), with 60% being adopted during March, April and May. As the markets normalized in the second half of 2020 and the risks related to opportunistic acquisitions and activist strategies declined, the rate of adoptions slowed and fell in line with prior years.<sup>5</sup> We expect the rate of rights plan adoptions to be consistent with historical (pre-COVID) low levels in the second half of 2021.



<sup>5</sup> Source: Deal Point Data.

# Energy Transition and the Role of the Board

Emily Leitch, Bill Nelson, Marwan Elaraby and Judy Little

In the past several years, the pace of what is now commonly referred to as “energy transition” — the global energy sector’s shift from predominantly oil, natural gas, coal and fossil-based sources of energy to renewable energy sources such as hydrogen, wind and solar — has accelerated significantly. Clean energy investment by oil and gas companies went from under \$5 billion in 2015 to \$12.7 billion in 2020.<sup>1</sup> Driving the transition are activist investors, institutional investors and regulators, with a recent assist from a Dutch court.

## NET ZERO EMISSIONS

A particular challenge to traditional oil and gas companies is the international call to slash greenhouse gas emissions to net zero by 2050, with interim goals to be achieved by 2030. Achieving this goal requires, among other things, new energy sources and new methods of reducing CO<sub>2</sub>. The emphasis on net zero emissions — a balance between emissions produced and those taken out of the atmosphere through technologies like carbon capture — is derived from a special report released by the Intergovernmental Panel on Climate Change (IPCC) in late 2018 in connection with the Paris Agreements (“Paris Accord”). This report asserts that net zero emissions by 2050 is a necessary step to mitigate global warming. Over 110 countries have endorsed this goal with most committing to net zero emissions.<sup>2</sup> Meanwhile, momentum has been growing in the private sector as many corporations, under pressure from

investors to show their commitment to easing climate change and to the long-term viability of their companies, have voluntarily followed suit.

In the energy industry, Repsol was the first to commit in 2018, while BP was the first supermajor to adopt net zero emissions in February 2020. In the United States, energy companies have been slower to make net zero commitments. ExxonMobil announced in August it was considering a plan to reduce net-carbon emissions to zero by 2050. Likewise, Chevron has pledged to limit carbon emissions that contribute to climate change but has not set net-zero targets.

In a landmark court ruling, a Dutch court held in May 2021 that Shell was partially responsible for climate change and that the net zero consensus of the Paris Accord applies globally and to non-state actors. Going further than the Paris Accord, however, the judge ordered Shell to reduce its carbon emissions by 45% by 2030 on an absolute basis.<sup>3</sup> The court recognized that the reduction would negatively affect Shell’s bottom line since oil and gas provide the majority of Shell’s revenues. According to the court, Shell’s commercial interests were outweighed by the interests of mitigating climate change. This ruling, which Shell is appealing, has already resulted in further climate change

litigation against non-governmental entities with, for instance, activists suing Volkswagen, BMW, Daimler and Wintershall DEA in a German court claiming the defendants’ current plans and measures contradict the Paris Accord and are, therefore, illegal.

## PROXY SEASON AND ACTIVIST INVESTORS

In 2020, a 53% majority of shareholders at Chevron voted for a resolution seeking a commitment from the oil giant to align its lobbying activities on climate policy with the goal of the Paris Accord. Climate Action 100+ investor signatory BNP Paribas Asset Management filed the first climate-related shareholder proposal ever to win a majority of Chevron shareholder votes, and it was the only proposal on Chevron’s 2020 proxy ballot that won a majority.<sup>4</sup>

Proving this was not an outlier, the 2021 proxy season saw a significant increase in shareholder support for climate-related proposals compared to 2020 and 2019. Climate-related proposals won majority support at ExxonMobil, Shell, Total, Phillips66, ConocoPhillips and again at Chevron, with Chevron’s shareholders voting 61% in favor of a proposal to cut Scope 3 emissions.<sup>5</sup>

<sup>1</sup> See Bloomberg NEF.

<sup>2</sup> See *United Nations*, “For a livable climate: Net zero commitments must be backed by credible action.”

<sup>3</sup> See Diederik Baazil and Laura Millan Lombrana, “What a Dutch Court Ruling Means for Shell and Big Oil,” *Bloomberg* (June 4, 2021).

<sup>4</sup> See Ceres, “Climate Action 100+ investor signatories achieve major gains during 2020 U.S. Proxy Season,” <https://www.climateaction100.org/news/climate-action-100-investor-signatories-achieve-major-gains-during-2020-u-s-proxy-season-2> (June 23, 2020).

Significantly, the ExxonMobil proxy fight was the first of its kind at a large U.S. company where the activist shareholder, a new hedge fund with a 0.02% stake in the company, focused on energy transition. The activist shareholder garnered the support of D.E. Shaw, BNP Paribas Asset Management and three institutional investors, BlackRock, Vanguard and State Street, and won three board seats (a quarter of the board), displacing incumbent directors. Key arguments were that ExxonMobil's strategy was inadequate to ensure a successful transition to a new low-carbon economy, ExxonMobil's directors lacked sufficient energy industry experience, and ExxonMobil's lobbying activities did not align with the company's stated ESG goals.<sup>6</sup>

In a similarly unprecedented investor action, Shell's shareholders nearly succeeded in vetoing Shell's plan to net zero that was announced the previous February. Activists accused Shell of greenwashing, noting that the plan included a 20% increase in natural gas production by 2030 to be offset by massive tree planting. With the support of Britain's biggest asset manager, activists advocated for a vote against the company's net zero plan, arguing it was not sufficiently ambitious.

A 2021 proxy season trend was the emergence of board-sponsored or shareholder-sponsored "say on climate" advisory votes that allow shareholders to approve or disapprove of the company's publicly available climate policies and strategies. At Total's annual meeting, 90% of its shareholders voted to approve a board-sponsored resolution supporting the company's ambitions on sustainable development and energy transition toward carbon neutrality and its related targets by 2030.

The resolution was largely driven by activist investors holding just over 1% of Total's outstanding shares who wanted Total to take more proactive steps toward decarbonization. Total also changed its name to TotalEnergies in June 2021 to evidence a broader commitment to energy sources.

ISS and Glass Lewis have updated their voting policies during the 2021 proxy season. The proxy advisors stated they will generally support proposals related to enhanced climate change disclosure, with ISS stating it will recommend voting for requests for reports on the feasibility of developing renewable energy resources and for proposals requesting that the company invest in renewable energy resources.

<sup>5</sup> Greenhouse gas emissions are categorized into three groups or "Scopes" by the most widely used international accounting tool, the Greenhouse Gas (GHG) Protocol. Scope 1 covers direct emissions from owned or controlled sources. Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in a company's value chain.

<sup>6</sup> See Rusty O'Kelley and Andrew Droste, "Why ExxonMobil's Proxy Contest Loss is a Wakeup Call for all Boards," *Harvard Law School Forum on Corporate Governance* (October 28, 2021).

## INSTITUTIONAL INVESTORS

From a capital-raising perspective, companies are finding that to stay in the green, they must make appropriate commitments to going green. As noted above, shifts in institutional investor support in the 2021 proxy season contributed to activist stockholders' success and may have influenced companies to reach agreements with activists prior to their annual meetings. BlackRock has clarified its expectation that companies disclose a plan for how their business model will be compatible with a low-carbon economy consistent with a global aspiration of net zero emissions by 2050. Vanguard updated its proxy voting guidelines in April 2021 to advise that it is likely to support proposals that request disclosure on how climate change risks are incorporated into strategy and capital allocation decisions, for an assessment of climate impact (including scenario analysis<sup>7</sup>) and/or request feasibility analysis.

State Street has published a call for boards of oil and gas companies to focus on adapting, not just mitigating, in the face of climate change.<sup>8</sup> As per State Street, boards should consider how climate change could fundamentally reshape the global opportunities amid the transition to a low-carbon economy. This scenario planning should be incorporated into the board's governance oversight structure and long-term strategic planning and be communicated to investors.

## ESG REPORTING AND THE SEC

Notably, U.S. oil and gas companies that have announced net zero commitments have done so using inconsistent standards. For instance, Occidental committed to net zero on all oil and gas it produces by 2040.<sup>9</sup> ConocoPhillips committed to zeroing out its direct greenhouse gas emissions by 2030.<sup>10</sup> Diamondback Energy pledged to be a net zero producer in Scope 1 emissions immediately.<sup>11</sup> Devon Energy and Pioneer Natural Resources have pledged to cut Scope 1 and Scope 2 emissions intensity in half by

<sup>7</sup> Scenario analysis is a risk analysis that can be applied to plausible climate futures to aid in understanding how climate change may impact a company. Climate scenarios are developed by considering an array of factors ranging from atmospheric changes to societal behavioral changes to new government policies to technological breakthroughs.

<sup>8</sup> See Michael Younis, "Climate-Related Disclosures in Oil and Gas, Mining, and Utilites: The Current State and Opportunities for Improvement," *State Street Global Advisers*, <https://www.ssga.com/investment-topics/environmental-social-governance/2019/06/climate-disclosure-assesment.pdf> (June 2019).

<sup>9</sup> See Reuters, "Occidental Petroleum announces net zero target for greenhouse gas emissions," <https://www.reuters.com/article/us-occidental-results/occidental-petroleum-announces-net-zero-target-for-greenhouse-gas-emissions-idUSKBN27Q2NU> (November 10, 2020).

<sup>10</sup> See ConocoPhillips, "Managing Climate-Related Risks: Emissions Reduction Targets," <https://static.conocophillips.com/files/resources/conocophillips-2020-climate-change-report.pdf> (2020).

<sup>11</sup> See Carolyn Davis, "Diamondback Sees No 'Clear Signal' to Boost Permian Output," *North American Gas Forum* (May 5, 2021).

2030. EQT announced targets to achieve net zero Scope 1 and Scope 2 greenhouse gas emissions in its production segment operations by or before 2025.<sup>12</sup>

To address comparability, in March 2021, the SEC requested public input from investors, registrants and other market participants on climate change disclosure with a view to facilitating the disclosure of consistent, reliable information on climate change, including, among other things, standardization of net zero disclosures.<sup>13</sup> For public companies, the question is not *if* the SEC will adopt new disclosure rules focusing on standardizing reports on climate change, but *when*.

## BOARD'S ROLE IN ENERGY TRANSITION

Against the foregoing backdrop, the present reality for publicly traded oil and gas companies is a need to adapt business models to seek investments in renewable energy and other mitigation technologies. Seeking to shift to a low carbon regime requires a balancing act of allocating capital that previously would have been earmarked for exploration and production, to projects related to the development of carbon capture, storage and sequestration, hydrogen, renewable diesel or renewable, certified natural gas, among others.

There is a growing expectation that boards will play an essential role in this transition, specifically with respect to overseeing the physical, regulatory, financial, reputational and other risks associated with climate change. For instance, BlackRock recently announced that it expects “boards to shape and monitor management’s approach to material sustainability factors in a company’s business model” and will hold directors accountable where they fall short. State Street intends to start voting against boards of companies that underperform their peers when it comes to ESG matters. Similarly, ISS and Glass Lewis have announced new voting policies that include director accountability for ESG governance failures. While there is no sure blueprint, a few key principles can help boards meet the unprecedented challenges they face in this rapidly changing, unpredictable and politicized space.

### Be Well-Informed

Directors’ fiduciary duties fundamentally require that they must be well-informed. For many companies, this includes having relevant information related to climate-related risks when making corporate decisions as to long-term business strategies, as well as exercising their oversight obligations.

- **Engage with Management.** It is important for management teams to brief boards regularly on climate and other ESG issues so that they can fulfill their obligation to oversee the company’s SEC disclosures. The board’s job is made more complicated by the fact that there currently are no across-the-board standards or metrics. In addition, by keeping an open door with management, boards can also be apprised of other investor concerns so that they are not surprised by activist attacks or institutional investor support of activists’ platforms. In promoting their cause, activists often seek to drive a wedge between the board and management.
- **Investigate Red Flags.** Directors also have a responsibility to investigate red flags that suggest potential legal or other risks to the corporation. If management is not comprehensively addressing climate risks and opportunities, directors may have to dig in on climate change (and other ESG issues) as the investor and stakeholder engagement and regulatory landscape continues to evolve.

### Discuss Climate Risk Regularly

Climate change and other ESG matters should be regular agenda items for the board, whether at meetings of the full board or in committees. In addition, an analysis of a selection of S&P 100 proxy statements found that 78% of companies had at least one board committee charged with overseeing environmental sustainability matters.<sup>14</sup> Of such companies, 42% reported at least one director with expertise in ESG.

### Seek Robust Shareholder Engagement

Activist shareholders will hone in on companies with boards that do not appear to be proactively and meaningfully contributing to a company’s approach to energy transition. Showing a willingness to engage and actively keep up with the rapidly evolving developments can serve as a strong defense against activist attacks. By employing an active shareholder engagement program, companies can better identify areas of concern before they rise to the level of very public shareholder proposals, “vote no” campaigns or proxy fights for board seats. Finally, now more than ever, it is important for companies to know who holds their stock and track accumulation from activist investors through a stock surveillance program.

<sup>12</sup> See EQT Corporation, “EQT Releases 2020 Environmental, Social and Governance Report and Announces Net Zero Emissions Targets,” <https://ir.eqt.com/investor-relations/news/news-release-details/2021/EQT-Releases-2020-Environmental-Social-and-Governance-Report-and-Announces-Net-Zero-Emissions-Targets/default.aspx> (June 29, 2021).

<sup>13</sup> See Allison Herren Lee, “Public Input Welcomed on Climate Change Disclosures,” *U.S. Securities and Exchange Commission* (March 15, 2021).

<sup>14</sup> See Kellie Huennekens, “ESG Disclosure in 2020 Proxy Statements,” *Nasdaq* (May 13, 2020).

# ESG Continues to Find its Way into Incentive Compensation Plans

Matthew H. Behrens & Annie P. Anderson

Although COVID-19 and its impact on business operations brought its own challenges to issuers' incentive compensation programs, a review of 2020 proxies showed no slowdown in the incorporation of ESG metrics into plan design. Traditional incentive compensation metrics, namely quantitative shareholder return and financial and operational metrics, still dominate but, increasingly, qualitative "social" factors, such as diversity and pay equity, are playing a meaningful role in executives' take-home incentive pay. In the Top 100 Companies, 15 have announced in their 2020 CD&As that incentive compensation for 2021 will include new ESG metrics. The move toward ESG metrics is both a response to stakeholder pressures and a growing recognition that these factors are important to long-term shareholder value.

This article discusses the forces leading companies to adopt ESG metrics, analyzes how those companies are incorporating ESG metrics into their incentive compensation programs and discusses the challenges of establishing meaningful metrics.



## THE FORCES OF CHANGE

A number of forces have led to the increased use of ESG metrics in incentive compensation plans. These include:

### 1 Institutional Investor Focus on Sustainability

In January of 2020, Larry Fink, Chairman and CEO of BlackRock, noted in his letter to CEOs that failure to focus on the needs of a broad range of stakeholders will ultimately damage long-term profitability. In his 2021 letter, Mr. Fink reiterated this position and called for a single global standard with respect to sustainability disclosures. Survey data shows that asset managers agree that a focus on ESG brings financial benefits. According to the 2020 RBC Global Asset Management (RBC GAM) Responsible Investing Survey, 75% of institutional investors in Canada, Asia, the United States and the United Kingdom apply ESG principles to investment decisions, with a 26% increase in Asia. In addition, 43% of the respondents said they believe ESG-integrated portfolios are likely to perform best, which is a 14% increase from 2019. Notably, the United States lags behind its peers, as only 28% of U.S. institutional investors polled held this view.

### 2 Shifting Views of the Role of the Corporation

In August of 2019, more than 180 CEOs signed onto a Business Roundtable statement that, for the first time, expanded the view that corporations exist principally to serve their shareholders to say that corporations should commit to serving the interests of all stakeholders, including shareholders, customers, employees, suppliers and communities. The Business Roundtable's position undoubtedly reflects increasing public, investor and employee pressure on companies to focus not only on advancing profits, but to also contribute to solving societal problems such as income inequality and environmental sustainability. The incorporation of ESG into incentive compensation plans is a key measure that observers will use to track whether the signatories' companies are honoring this new philosophy.

### 3 Regulatory Activities

In March of 2021, the SEC requested public input on climate change disclosure and tasked the staff with evaluating SEC disclosure rules related to climate change. The SEC received more than 550 unique comment letters in response, and three out of every four letters was in support of mandatory climate disclosure rules. SEC Chair Gary Gensler subsequently announced that the staff is developing a mandatory climate risk disclosure rule for the SEC’s consideration by the end of the year, emphasizing that investors are looking for “consistent, comparable, and decision-useful” disclosures in this regard. In addition, the removal of the “performance-based compensation” exemption from Section 162(m) of the tax code provides companies with greater latitude to use qualitative performance metrics and to implement a bonus “modifier,” which enables the company to increase the payable bonus as a result of a subjective determination, such as a commitment to the company’s ESG principles.



#### The Challenge of Metrics

Boards looking to incorporate ESG metrics into incentive compensation plans are faced with the dual challenge of choosing appropriate metrics and appropriately measuring success. Although there is a movement toward establishing a global set of standards for reporting ESG metrics — as is the case with financial reporting — there is an ongoing debate as to whether a global set of ESG standards is, in fact, beneficial. For example, in April of 2021, SEC Commissioner Hester Peirce argued that a “global

reliance on a centrally determined set of metrics could undermine the very people-centered objectives of the ESG movement by displacing the insights of the people making and consuming products and services.”<sup>1</sup> Further, for any individual issuer, the chosen set of global standards required to be reported on may not align with the long-term business strategy of the issuer and, therefore, may not be appropriate as an incentive compensation metric.

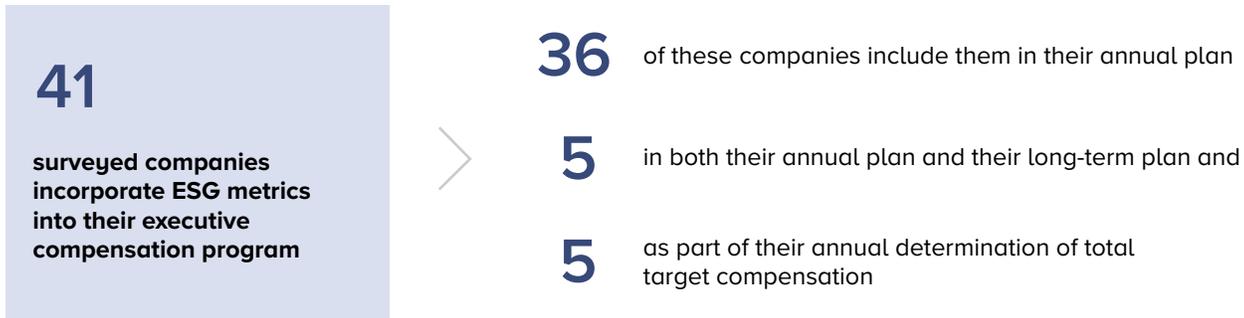
As issuers continue to grapple with how best to incorporate ESG metrics in their incentive compensation programs, most provide for a qualitative review and include the metrics as part of an overall review of individual performance. Regardless of how the ESG metrics are utilized, they should come coupled with transparent disclosure to investors as to how and why the metrics were chosen, weighted and evaluated.



<sup>1</sup> See Hester Peirce, “Rethinking Global ESG Metrics,” *Views – the Eurofi Magazine*, page 208 (April 2021). (Also available at <https://www.sec.gov/news/public-statement/rethinking-global-esg-metrics>).

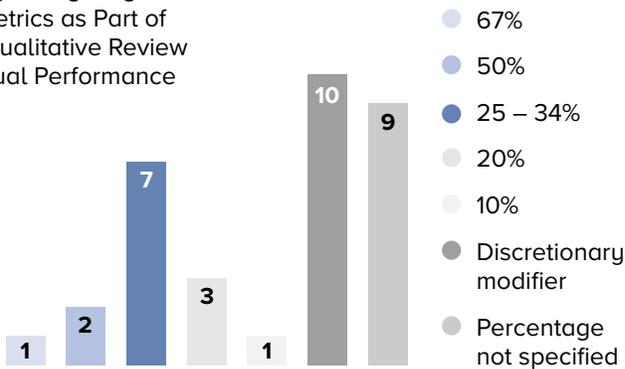
## ESG METRICS IN THE INCENTIVE COMPENSATION PLANS OF THE TOP 100 COMPANIES

Of the Top 100 Companies:



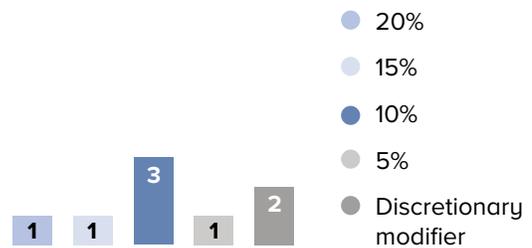
**33** of the Top 100 Companies incorporate ESG metrics into a holistic qualitative review of individual performance

Percentage Weighting of ESG Metrics as Part of Holistic Qualitative Review of Individual Performance



**8** of the Top 100 Companies include ESG as an individual metric (one company includes ESG as an element of a holistic qualitative review and also as an individual metric)

Weighting of Individual ESG Metric



ESG means different things to different companies. This is how companies that used ESG metrics defined ESG:



## ACTION ITEMS FOR INCORPORATING ESG METRICS

The following is a list of action items for companies looking to incorporate ESG metrics into their incentive compensation programs:

### 1 Engage with Shareholders

As part of a company's regular calendar on shareholder engagement, the company should discuss with key shareholders the inclusion of ESG metrics into its incentive compensation programs. Companies should seek to emphasize that these metrics are not divorced from the interests of shareholders but are, in fact, value drivers.

### 2 Identify the Appropriate Metrics

Consider a task force comprising different stakeholders within the organization that can appropriately determine ESG metrics that reflect the company's strategy and key risks and promote value creation.

### 3 Ensure a Line of Sight between Executive Actions and Performance

Incentive compensation metrics are without value if employees do not have the ability within their job function to impact the desired outcome. For example, while improved safety may be an important goal for an organization, it is likely the controller has little ability to effect change in this regard and his or her attention should be directed toward other goals of the company.

### 4 Set Goals

With a lack of historical context by which to measure ESG progress, consider providing the compensation committee with discretion to determine how executives have performed with respect to the company's ESG goals. Although companies may decide to measure success against targets set by third parties, such as SASB, these external targets may not be appropriate for every individual company. Also, determine whether goals should be annual or long-term. As shown in the Survey data, most ESG metrics are tied to annual incentive plans, reflecting the long-held belief that long-term goals should relate to financial and shareholder return metrics.

### 5 Review Your Executive Officer Scorecards

As discussed, unlike financial metrics, ESG performance cannot be boiled down to numbers on a spreadsheet and requires a subjective analysis. Therefore, when evaluating the overall performance of the company's executive officers, the board should include relevant ESG metrics on its scorecards.

## The DOL's Rules on ESG Investing for ERISA Plans – The Pendulum Swings Again

In December 2020, the Department of Labor (DOL) published a final rule with respect to ESG investing in the ERISA context. Purporting to reflect the DOL's long-standing position that ERISA fiduciaries may not sacrifice investment returns in order to promote social, environmental or other policy goals, the rule provided that ESG factors may be considered only to the extent they present material economic risks or opportunities. The rule was not without controversy, as evidenced

by the over 8,000 comment letters sent to the DOL following the initial release of the proposed rule.

Reflecting the long-standing back and forth between Republican and Democrat administrations as to the role of ESG considerations in ERISA investing, the Biden administration announced it would not enforce the rule and, on October 13, 2021, the DOL promulgated a new proposed rule. The proposed rule addresses concerns that the previous rule put fiduciaries at risk if they considered ESG factors

in their financial evaluation of plan investments. Therefore, the proposed rule eliminates the requirement that fiduciaries only consider "pecuniary factors" in making investment decisions and allows fiduciaries to consider any factor that is material to the risk-return analysis. Therefore, the proposal would allow fiduciaries to consider ESG factors, including climate change-related factors.

# Recent Corporate Governance Developments in the U.K.

Phil Cheveley and Michael Scargill

Corporate governance reform has been under the spotlight recently in the U.K., with three major reviews being carried out into U.K. company audits and, more generally, corporate governance practice and regulation. The first review (the so-called Kingman Review) reported in December 2018 and was concerned with the work and structure of the U.K.'s independent audit and corporate governance regulator, the Financial Reporting Council (the FRC) and its proposed replacement by a new regulator. The second review reported in April 2019 and was carried out by the U.K.'s

antitrust regulator, the Competition and Markets Authority (CMA), into the statutory audit services market. The third review (the so-called "Brydon Review") reported in December 2019 and was concerned with improving the quality and effectiveness of statutory audits in the U.K. In March 2021, the Government published its conclusions and responses to these three reviews, setting out very significant (and in some cases controversial) proposals for reform in its "Restoring trust in audit and corporate governance" White Paper (the Paper).

The earlier reviews were prompted, in part, by a number of very notable corporate failures in the U.K., which have raised serious questions about the adequacy of existing risk and internal control processes and strategy in U.K. corporates and about the work and oversight of U.K. corporate financial reporting and governance by the FRC.

Consultation on the Paper's proposals closed in July 2021, and the Government is now reviewing the feedback it has received on its proposals.

## THE GOVERNMENT'S WHITE PAPER

The bulk of the Paper addresses the Kingman Review proposals for a new regulator to replace the FRC and its new and enhanced powers and responsibilities, as well as the Brydon Review and CMA report on reform of the audit function and audit market. The Paper also proposes significant changes to director liability and responsibility in relation to corporate or financial reporting and payment of dividends and to enforcement and malus or clawback action in relation to director remuneration that might be taken against directors in respect of any breaches of their existing and proposed new duties and responsibilities.

The Government has accepted in principle all the findings of the three earlier reviews but, conscious of the pressures many companies will be under as they emerge from the pandemic, is proposing a phased introduction of the reforms. Any necessary legislation will be introduced as and when Parliamentary time allows, and it is proposing introducing

certain reforms (e.g., corporate reporting) initially for premium-listed companies and possibly two years later for certain other unlisted public interest enterprises (PIEs). The Government is consulting on the tests to be applied for the extension of the current PIE status (which attracts certain corporate reporting and governance requirements) from listed to large unlisted companies or groups, focusing on number of employees and turnover or balance sheet size. Depending on the tests adopted, a further 1,000 to 2,000 companies could be brought into this expanded regime for U.K. PIEs.

There are four principal areas in the Paper's proposals concerned with corporate governance: (i) corporate reporting, (ii) director liability in relation to dividend payments and corporate reporting generally, (iii) the work of audit committees and (iv) the role and powers of a new regulator to replace the FRC.

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## CORPORATE REPORTING

The key reforms proposed in connection with U.K. corporate reporting concern three critical areas of new or enhanced disclosure by the board in its company's annual report — the company's internal controls, its resilience to coping with future risks and uncertainties and its approach to seeking internal and external assurance of its corporate reporting.

### Internal Control Statement

The Paper acknowledges that some recent well-publicized corporate failures have shown that the U.K.'s current mix of legal, listing rule and U.K. Corporate Governance Code (the "Governance Code"), etc. requirements for companies' internal controls have not worked as well together as they need to. It therefore proposes addressing head-on the responsibility of directors for the adequacy of their company's internal controls by requiring the board to confirm expressly on an annual basis that it has reviewed the effectiveness of the company's internal controls and how any deficiencies that have been identified are being remedied.

This will, at least as a matter of disclosure, involve much more than the current requirement of the Governance Code that the board simply confirms it has reviewed the effectiveness of the company's internal controls. It is also notable that consistent with the U.K.'s general approach of a board's collective responsibility (with no legal differentiation between executive and non-executive directors in terms of their duties as directors), the Government is proposing that the board, rather than just the CEO and CFO as under the U.S. Sarbanes-Oxley rules (SOX), should give this confirmation. The board will be required to acknowledge its responsibility for maintaining adequate internal controls for financial reporting and, after annual review, to confirm the effectiveness of those controls in a statement included in the annual report. Significantly, the Government is not proposing, as its initial preferred approach, requiring external auditor assurance or attestation of the statement, except in limited cases where, for example, there has been a serious and demonstrable internal controls failure. It has, however, also invited comments on the adoption of a more SOX-aligned approach with mandatory external attestation.

### Resilience Statement

The second new reporting disclosure that is proposed will require directors to commit to a much clearer and more expansive public commentary on their company's financial and operational strength and viability over the short-to-medium and longer term than is currently the case.

This proposed Resilience Statement would build on and consolidate the going concern and viability statements that are currently required in annual reports but would demand much more disclosure and analysis from the board than is commonly the case for the existing

disclosures. The statement would set out the company's approach to exploring and mitigating risks and uncertainties over the short term (one to two years), the medium term (five years) and the longer term. Disclosure would be required of material uncertainties looked at by the board during its going concern assessment but subsequently judged not to be material, including because of mitigating action taken. In addition, boards would be required to include in their Resilience Statement at least two reverse stress-testing scenarios.

### Audit and Assurance Policy

A further new reporting disclosure would require directors to be much more open about the level of external assurance the board seeks when reporting the company's results and financial position to the markets. This proposed **Audit and Assurance Policy** would be made in the annual report, either each year or every three years. Critically, it would also be subject to an advisory shareholder vote (for listed PIEs) when published.

The Policy would have to describe the company's approach to seeking internal and external assurance of its corporate reporting over the next three years and would mark a major extension and clarification of the level of external scrutiny that companies currently invite on their corporate reporting. It would extend well beyond the existing required audit of statutory information (including non-financial information) found in the directors' report and strategic report and also various non-statutory information. This Policy might also disclose the extent to which the board has looked for any external assurance of its Resilience Statement.

The response of proxy advisers to companies' Resilience Statements and the requirement for a shareholders' vote on the Audit and Assurance Policy (with the likely sanction of having a 20% or more vote against it being recorded on the Investment Association's public register), is likely to put boards under greater pressure to articulate more clearly and more robustly to their shareholders and other stakeholders how they see their companies are placed to weather future financial, pandemic and other economic or operational challenges.

These new Internal Control, Resilience and Audit and Assurance Policy statement requirements would apply initially to premium-listed PIEs and then be rolled out to a broader range of other PIEs (as mentioned above) two years later.



## NEW DIRECTOR LIABILITY REGIME

To encourage a greater focus by directors on the new and enhanced reporting disclosure obligations for companies, the Paper proposes a new regime for policing and enforcing the responsibility of directors for discharging those obligations. Specific proposals are also made with respect to the legal responsibility of directors and companies when paying dividends and the withholding or clawback of director remuneration in cases of serious corporate failure.

### Enforcement Action

It is proposed that, in the case of their existing and new responsibilities in relation to corporate reporting and audit-related matters, PIE directors should become subject to enforcement action by the new audit and corporate reporting regulator that will replace the FRC — the Audit, Reporting and Governance Authority (ARGA). These enforcement powers would sit alongside the existing enforcement powers available under the U.K. Companies Act and under FCA rules and the Insolvency Service. Secondly, differing from the Kingman Review, the Paper proposes that all PIE directors should be subject to this new corporate reporting and audit duties enforcement regime and not just the CEO, CFO, board chair and audit committee chair. Thirdly, the Paper proposes that ARGA be empowered to impose more detailed requirements in relation to the duties falling within its enforcement regime, including, possibly, additional behavioral standards (such as acting with integrity and honesty).

ARGA would have powers to investigate possible breaches of these duties and to impose a range of civil sanctions such as reprimands, fines, orders to take mitigating action and even the issue of a temporary prohibition on acting as a PIE director.

### Dividends

In relation to the payment of dividends, two major changes are proposed. The first addresses a longstanding concern that companies are not currently required to disclose in their accounts the amount of their distributable profits — i.e., the maximum legal amount that the Companies Act allows a company to distribute to its shareholders. The Government is proposing that companies should be required to state in their annual report the total amount of reserves that are distributable (or at least the minimum distributable amount), both on an individual parent company basis but also for the group as a whole by way of an estimate of the potential distributable reserves across the group companies that might be distributed up to the parent company.

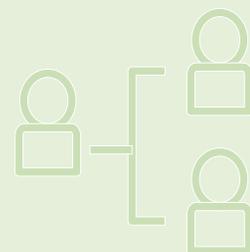
The second change is more significant, since it would require directors to confirm that not only are they satisfied that a payment of a particular dividend is within the company's distributable reserves and consistent with their fiduciary duties, but that they reasonably expect that it will not threaten the solvency of the company over the next two years in light of their risk analysis and knowledge of the company's position when the dividend is proposed. The directors would also have to confirm that the dividend is consistent with any annual Resilience Statement that their company is required to make.

The Paper indicates that the purpose of this new dividend confirmation would be to focus the board's mind on the appropriateness of declaring the particular dividend, as well as making it easier for legal action to be taken against directors who pay any dividends in breach of their fiduciary duties, etc. The Government proposes that these new requirements should only apply to listed or AIM-traded companies but is open to arguments that they should also apply to other PIEs, such as the proposed additional category of large unlisted PIEs mentioned above.

The new "two-year" solvency confirmation is particularly noteworthy, since it contrasts with the one-year solvency statements required for private company capital reductions and capital-funded share buybacks.

### Remuneration Clawback

In relation to executive director remuneration, the Government intends to ask for the Governance Code's existing requirements for clawback (or withholding) of director remuneration to be strengthened so that they apply to a minimum set of conditions and with a minimum period of at least two years following the award. Depending on how effective these new Governance Code requirements prove to be, the Government reserves the option of extending them to all listed companies through changes to the listing rules.



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## AUDIT COMMITTEES

Recognizing the critical role and responsibility that audit committees play in relation to their companies' external audit, the Government is proposing empowering ARGA to impose additional scrutiny and other requirements on audit committees with respect to their appointment and oversight of the work of external auditors. The focus will be on continuously monitoring audit quality and consistently demanding challenge and skepticism from auditors. The FRC already issues guidance for audit committees, and ARGA will be expected to continue to assist audit committees with its own guidance where appropriate.

Shareholders will also be encouraged to have more engagement with their company pre-audit with the Paper's proposal that audit committees should seek shareholder views on the annual audit plan. The utility of that particular reform will, of course, depend on the willingness and

commitment that institutional shareholders have to step up to the greater stewardship responsibilities and opportunities that these corporate governance and reporting reforms will offer.

ARGA will be given a range of powers to enforce compliance with the new requirements, including calling for information from audit committees, issuing public notices detailing any findings in relation to failures to meet the new requirements, as well as, in appropriate cases, placing an observer on an audit committee or issuing direct statements to shareholders where ARGA is not satisfied with the action taken by a particular audit committee.

These new requirements would initially apply to FTSE 350 companies but might be extended to other PIEs at a later date.

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## ARGA – A NEW REGULATOR

Following the publication of the Kingman Review, the Government wasted no time in announcing that it would take action to replace the FRC with a new regulator. Some of the alleged failings (or at least difficulties) of the FRC in regulating effectively and proactively corporate reporting and governance have been put down to the lack of clear statutory powers that it has in those areas, coupled with a perceived lack of focus in its regulatory agenda and remit. In addition, it is somewhat odd that a regulator with the importance that the FRC has to the U.K. economy, business and capital markets is still reliant, at least to some extent, on voluntary funding from market participants.

The Paper proposes major changes to the regulator to address these issues. ARGA will be set up on a statutory basis with much clearer and more extensive regulatory powers and with a much clearer and better-defined remit than the FRC currently has.

It will have, as a general objective when carrying out its policy-making functions, the protection and promotion of the interests of investors, other users of corporate reporting and of the wider public interest, supplemented by more specific duties, which will include promoting high-quality audit, corporate reporting, corporate governance, accounting and actuarial work, as well as effective competition in the statutory audit services market. It will also be funded by a new statutory levy mandatorily payable by market participants.

In advance of legislation being introduced to make some of these changes, the FRC has already made important changes to its leadership and board to help improve its internal governance.

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## CONCLUSION

These proposed reforms are undoubtedly significant for corporates and their auditors and, insofar as they aim to bring about clearer and more focused risk assessment and reporting by boards, have been largely welcomed by investors. Nevertheless, concern has also been expressed about possible regulatory overload and the potential conflict and impact of the proposals, including their cost, on the competitiveness of U.K. businesses, particularly at a time when the Government is also trying, through its major Listing Regime Review reforms, to make the U.K. a more attractive place in which businesses may choose to set up and list. As always, the proof will be in the pudding — will the new reporting requirements, onerous and demanding as they will be for many corporates and their boards, lead to fewer "accounting" scandals and failures in the future? Probably not by themselves, which is why the prospect

of PIE directors being required to meet certain behavioral standards is of particular interest, but also of some concern as to how the new liability regime would interact with the existing liability regimes for U.K. directors. Whether the enhanced enforcement powers of the new regulator and the Paper's other proposals with regards to enhanced PIE audits and measures to increase competition in the statutory audit services market will also succeed in improving U.K. corporate reporting and governance, remains an issue in debate, particularly as regards resourcing and capacity concerns. The challenge now lies with the Government to prioritize those reforms which both corporates and investors can agree are likely to bring about the sorts of improvement to the U.K.'s corporate governance regime that recent corporate failures have highlighted.



## The Survey

The Survey consists of a review of key governance characteristics of the Top 100 Companies, including a review of key ESG matters.



**58**

of the Top 100 Companies  
had 30% or more women  
on the board

**89**

of the Top 100 Companies  
have added one or more  
female directors since  
September 30, 2018

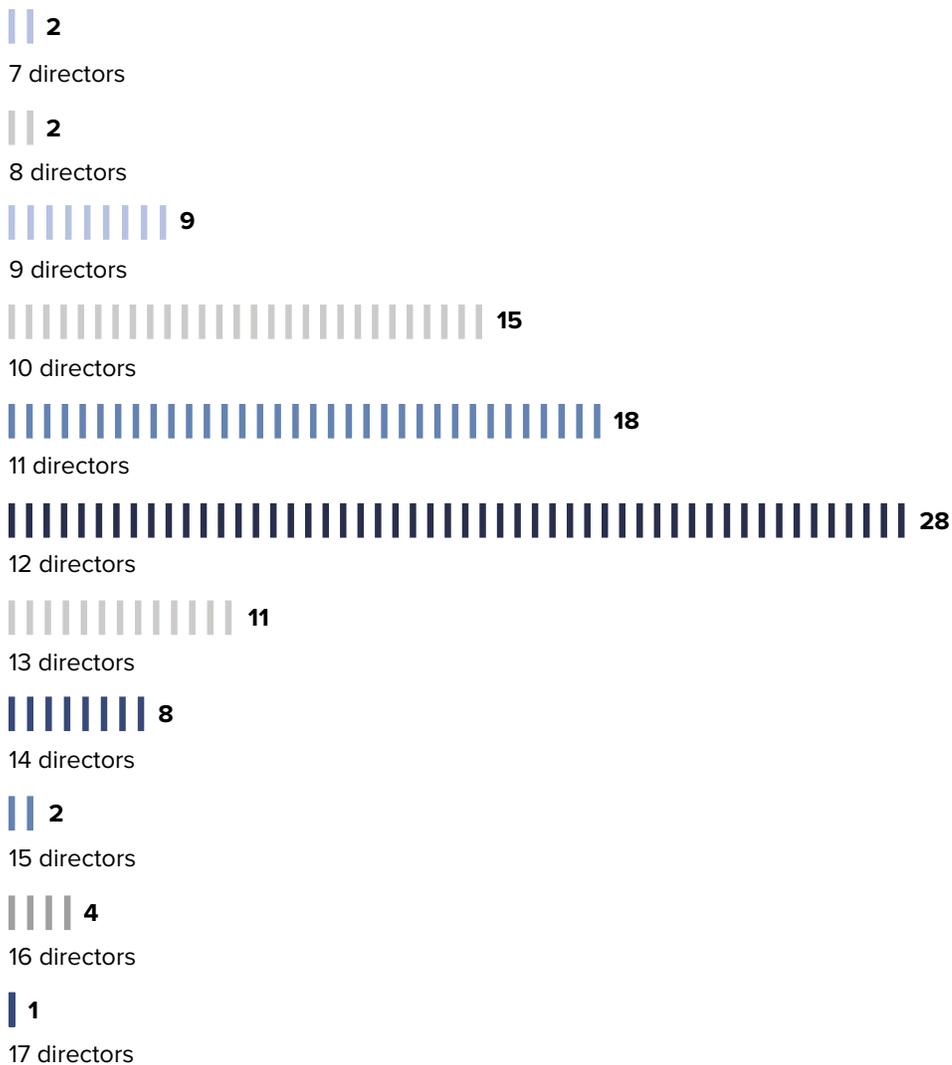
**6**

board chairs of the Top 100  
Companies are women

# Board Size and Leadership

The average size of the board of the Top 100 Companies has decreased from 12.5 directors in 2015 to 11.6 directors in 2020, and 39 of the Top 100 Companies have split the CEO and board chair positions.

## Board Size of the Top 100 Companies



## Size of the Board

The Board Size of the Top 100 Companies Ranged from

7 to 17  
directors  
with an  
average of



11.6  
directors

The Board Size of

72 of the  
Top 100  
Companies  
ranged from



10-13  
directors

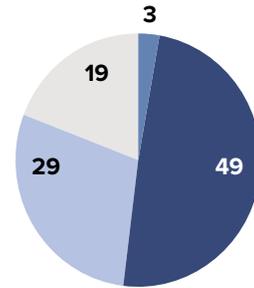
Of the Top 100 Companies



**Have a Lead Independent Director**



**Had an Executive Officer as a Board Chair the Last Three Years**



- Same CEO and Chair with no Lead Independent Director
- Same CEO and Chair with Lead Independent Director
- Separate CEO and Chair (Chair Independent)
- Separate CEO and Chair (Chair not Independent)

\* One Top 100 Company did not have a Chair of the board.

Separation of the CEO and Chair

A large donut chart with a dark blue center containing the number 48, surrounded by a light blue ring that is 48% filled.

**48**

**of the Top 100 Companies currently have separated the roles of board chair and CEO**

Of Those Companies



**have independent board chairs**



**board chairs of the Top 100 Companies are women**

## Director Independence

Independent directors constituted an average of

**86%**

of the directors on the boards of the Top 100 Companies.

Over the last 10 years, the number of companies at which the CEO is the only non-independent director has increased significantly.



of the Top 100 Companies have boards composed of 75% or more independent directors

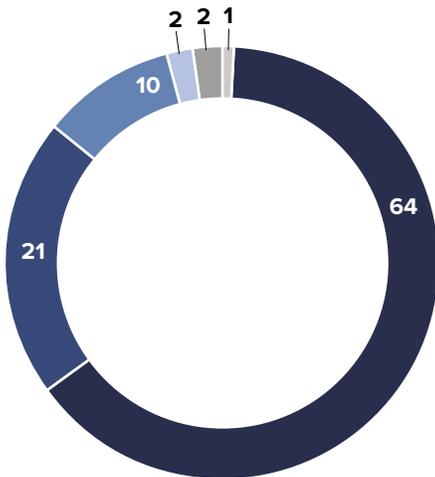


of the Top 100 Companies have management directors (other than the CEO) who are not independent, including one of the Top 100 Companies that has its CFO on the board and three of the Top 100 Companies that have their COO on the board



of the Top 100 Companies have non-management directors who are not independent

## Number of Non-Independent Directors\*



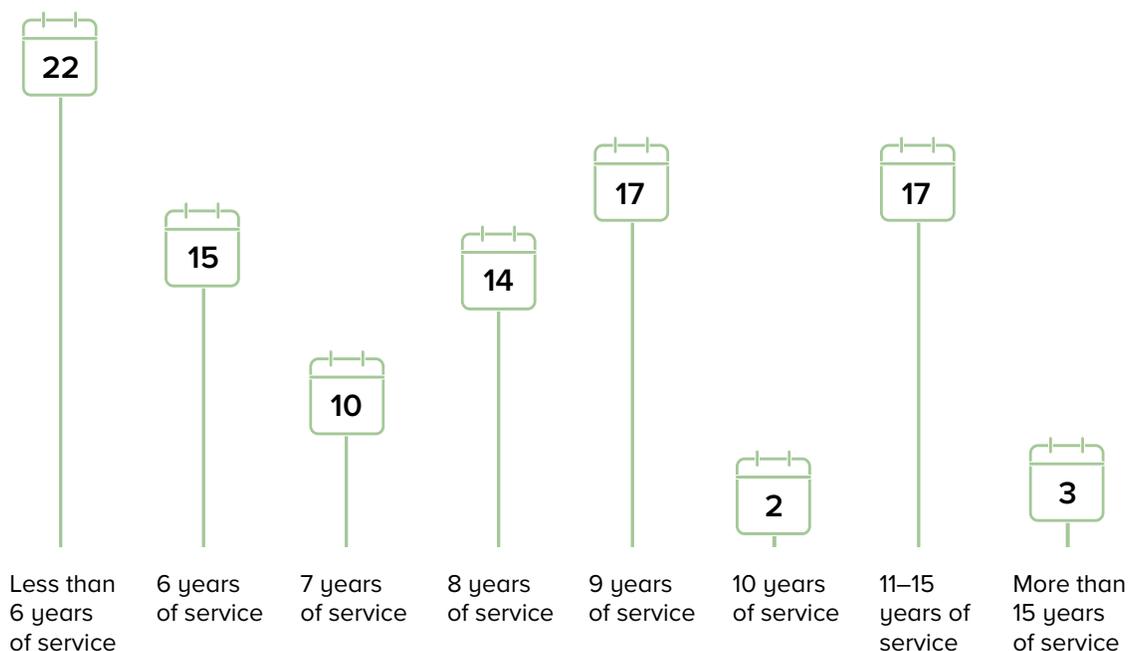
- One non-independent board director
- Two non-independent board directors
- Three non-independent board directors
- Four non-independent board directors
- Five non-independent board directors
- Six non-independent board directors

\* Includes one company where the two non-independent directors are co-CEOs.

# Board Refreshment

Board refreshment continues to be one of the key issues facing nominating and governance committees, and boards as a whole, as they are increasingly under pressure to change the face of the boardroom by re-examining topics such as director tenure, experience, performance and diversity, with gender and ethnic diversity at the forefront.

## Average Director Tenure

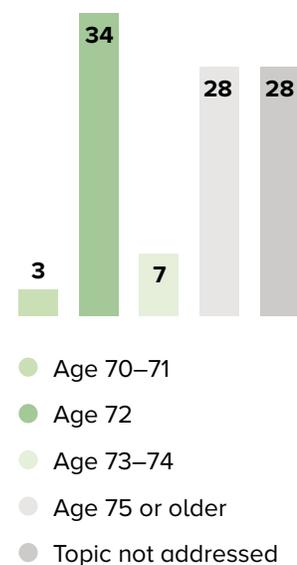


## Mechanisms to Encourage Board Refreshment

Three of the principal board refreshment mechanisms are mandatory retirement age, term limits and the board self-evaluation process. While the use of a mandatory retirement age mechanism continues to be high and term limits continue to be low, use of the board self-evaluation process mechanism appears to be increasing.

## Mandatory Retirement Age

Although not required by either the NYSE or Nasdaq listing standards, 72 of the Top 100 Companies have disclosed a mandatory retirement age for their non-management directors. Of these, 43 companies expressly permit the board or a committee of the board to make exceptions to the retirement age policy. Age 72 continues to be the most common age set for mandatory retirement.



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## Term Limits

Six of the Top 100 Companies have adopted mandatory term limits for their directors, a slight decrease from eight in 2020. The mandatory term limits apply only to non-management directors at four of these companies. 66 of the Top 100 Companies specifically state that term limits have not been adopted, most citing the value of the insight and knowledge that directors who have served for an extended period of time can provide about the company's business. Many of these companies also state that periodic reviews by the board or a board committee of each director's performance serve as an appropriate alternative to mandatory term limits. Of the sixty-six Top 100 Companies that specifically state that term limits have not been adopted, two adopted average tenure limits of 10 years and one adopted an average tenure limit of nine years.



State that term limits should not be adopted



Do not address the topic of term limits



Have term limits ranging from 15 to 20 years



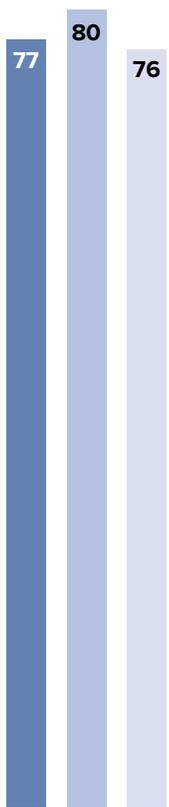
Have adopted average tenure limits instead



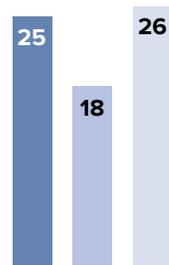
# Board Diversity

Companies vary considerably in how they present information regarding board diversity in their proxy statements. In 2021, the number of Top 100 Companies that presented information about the diversity of their boards on a director-specific basis increased to 2019 levels from 18 companies in 2020 to 26 companies in 2021.

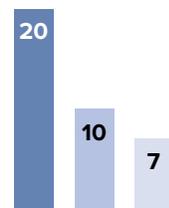
### Aggregated Diversity Information For All Directors\*



### Director-Specific Diversity Information Presented\*



### No Board Diversity Information Presented



● 2019 ● 2020 ● 2021

\*Includes companies that presented both aggregated and director-specific diversity information.

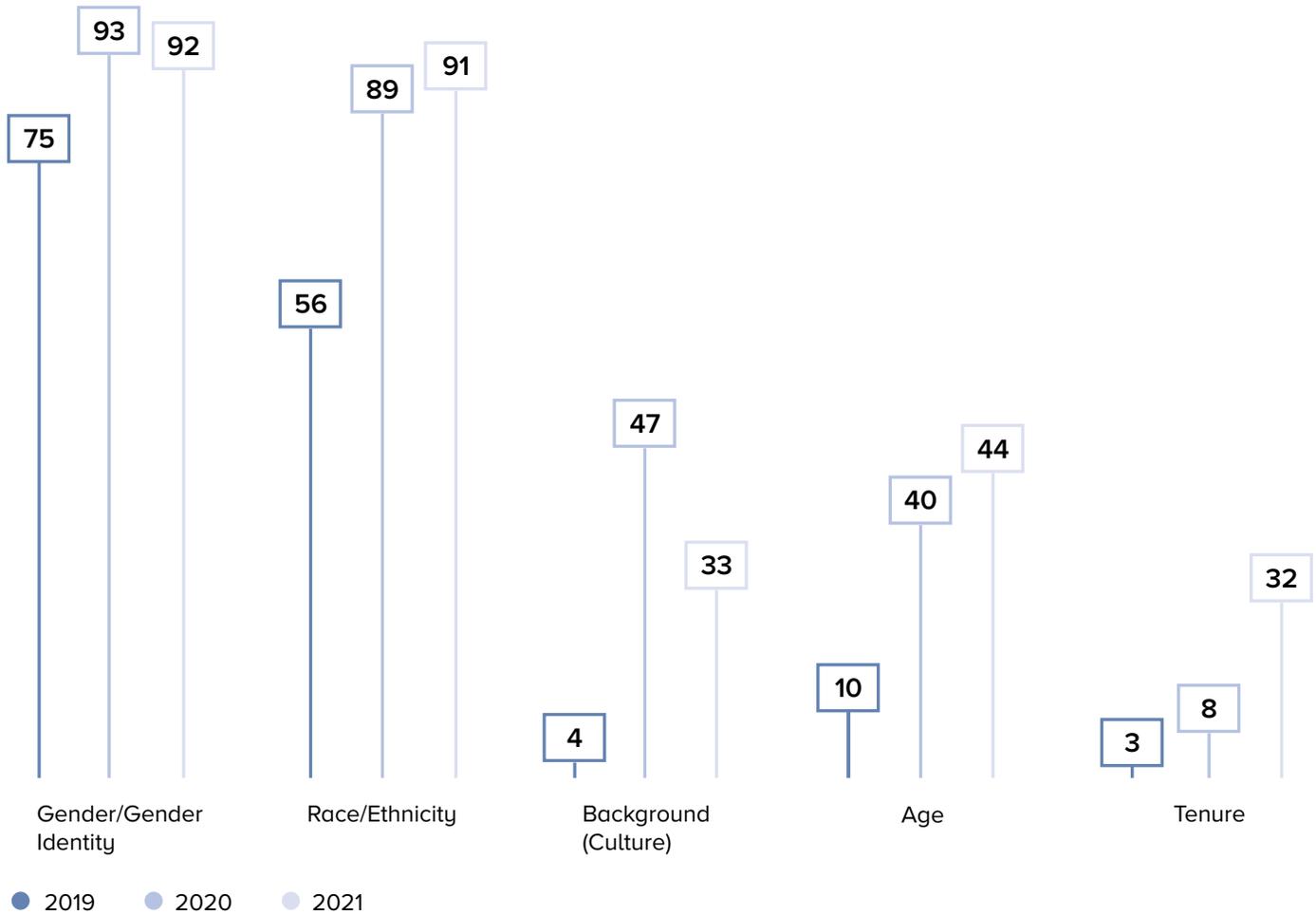
Sixty-three Top 100 Companies that have presented aggregated diversity information in 2021 had presented diversity information in separate categories.

### Presented Diversity Information in Separate Categories

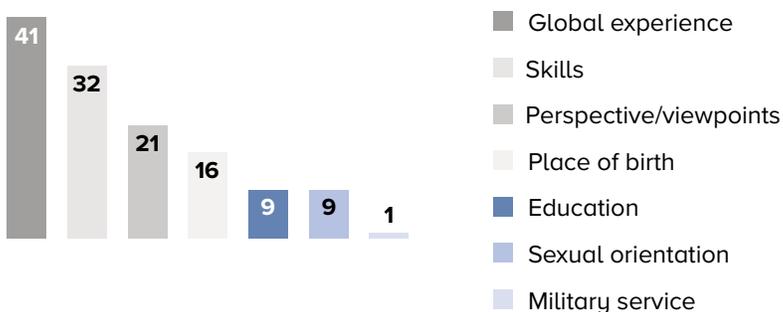


Nasdaq's new disclosure requirements on board diversity includes a requirement to present diversity information in a prescribed matrix.

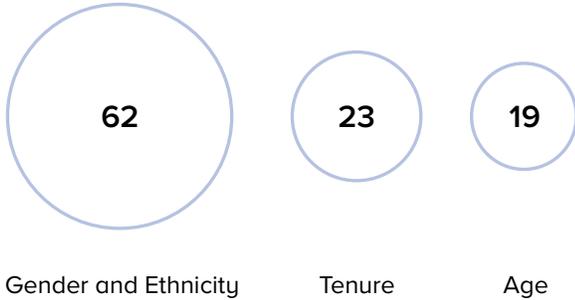
The most commonly identified categories of board diversity continue to be gender/gender identity, which decreased slightly from 93 companies in 2020 to 92 companies in 2021, and race/ethnicity, which increased from 89 companies in 2020 to 91 companies in 2021. These changes likely reflect a change in the composition of companies included in the Top 100 Companies. Various other categories that were presented included age, the cultural background of directors, such as national origin, citizenship and place of birth and tenure.



### Others

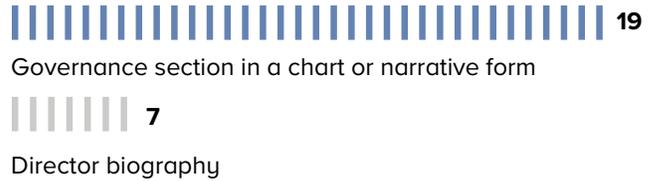


**Of the 63 Top 100 Companies that had Presented Aggregate Diversity Information in Separate Categories, the Below Categories were Presented\***



\* Includes companies that presented more than one category of aggregate diversity information.

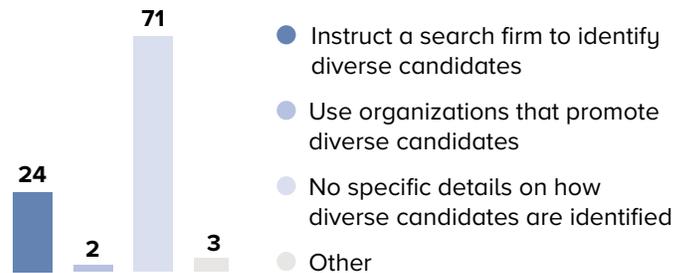
**Of the 26 Top 100 Companies that had Presented Director-Specific Diversity Information, the Information was Presented in\***



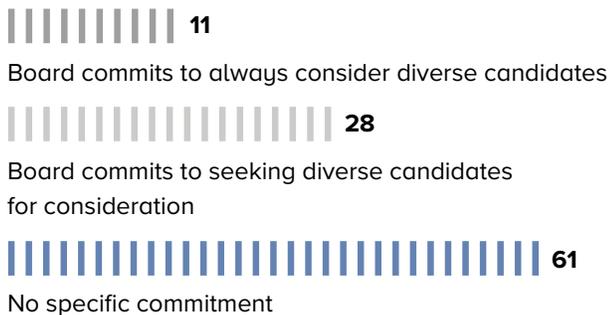
\* Includes companies that presented director-specific diversity information in both director biographies and in the governance section in a chart or narrative form.

**1** One of the Top 100 Companies committed to a percentage or number of diverse representation on the board

**Board's Approach to Identifying Diverse Director Candidates**



**Board Commitments to Always Consider Diverse Candidates in Connection with Identifying New Director Nominees ("Rooney Rule")**



**35** of the Top 100 Companies have added one or more female directors since their 2020 annual meeting

**24** of the Top 100 Companies have headquarters/principal executive offices in California

**Of those 24:**

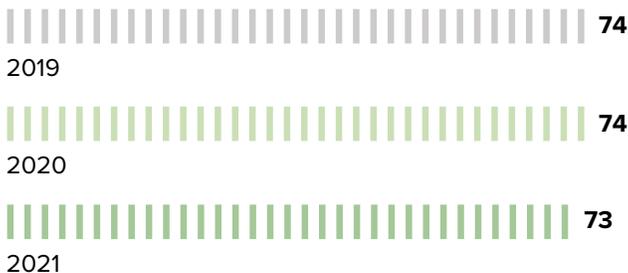
**9** companies have added one or more female directors since its prior proxy was filed

# Director Skill Set

## Director Skills Matrix

One of many initiatives to encourage public companies to encourage board refreshment and promote diversity on public company boards has been to encourage public companies to add a director skills matrix as part of their proxy statement disclosures.

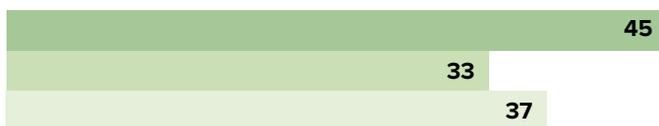
### Director Skills Matrix Presented



No Matrix Provided

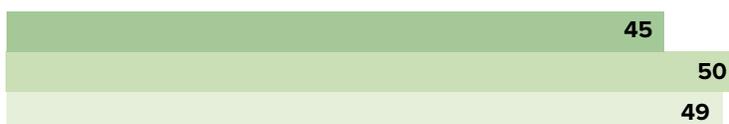
Companies vary considerably in how they present the experience, qualifications, attributes and skills of directors in the matrix. The information may be presented in the aggregate or identify specific directors who have such experience, qualifications, attributes and skills.

### Aggregated Information\*



Of the 25 companies that presented director skills in an aggregated format only, 22 companies presented the information by number of directors and three companies presented the information as a percentage of the total board.

### Individual Director Information\*



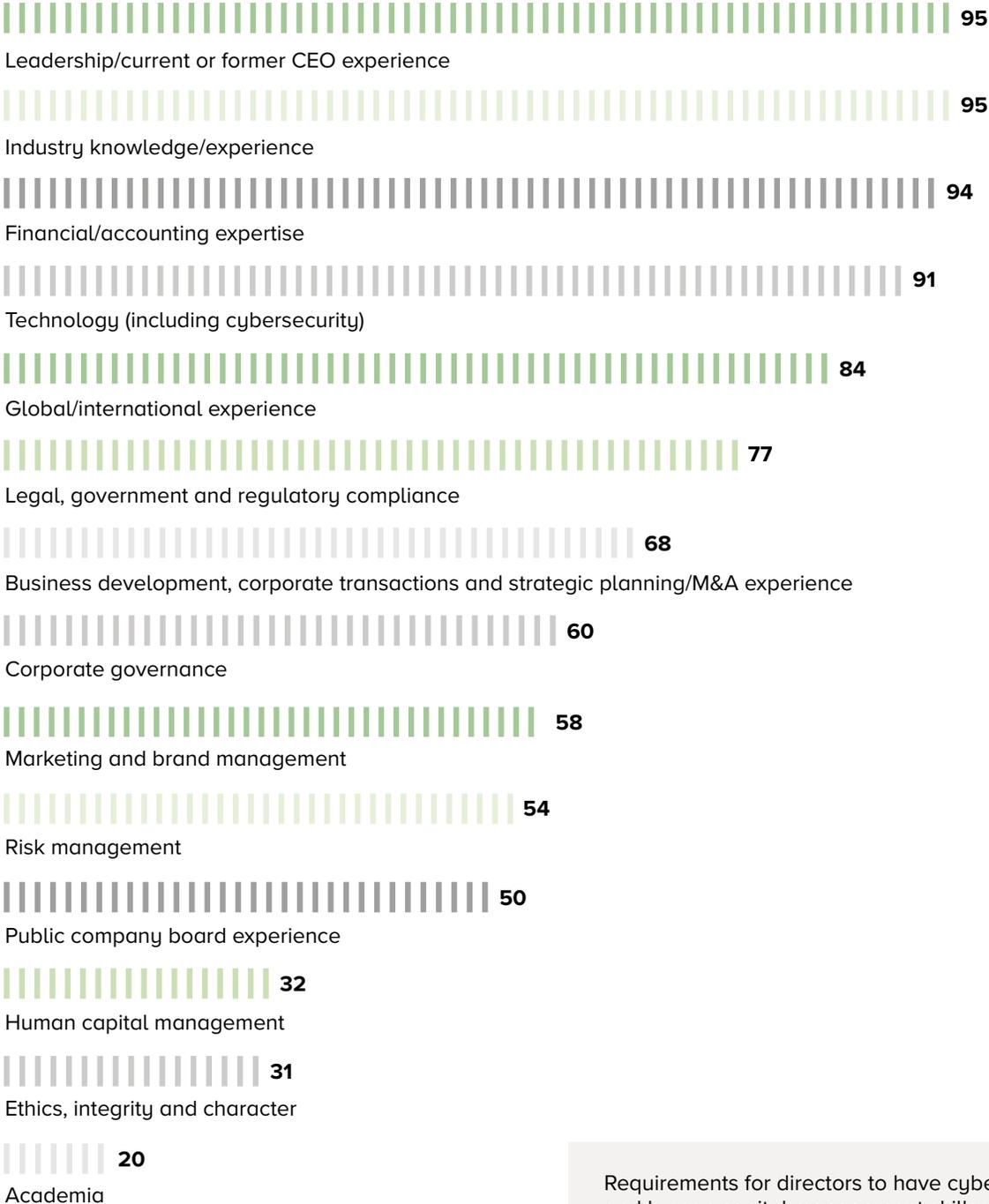
● 2019 ● 2020 ● 2021

\*12 of the Top 100 Companies included both aggregated information and individual director information in their director skills matrix.

## Board Skills Information

SEC rules require companies to disclose the “experience, qualifications, attributes and skills that led to the conclusion that the person should serve as a director for the registrant at the time the disclosure is made, in light of the registrant’s business and structure.” As a result of this disclosure requirement, companies typically discuss director experience, qualifications, attributes and skills as part of each director’s biography. There is a continued trend in presenting this information in a matrix format so that shareholders can have a clearer picture of the experience, qualifications, attributes and skills of the board as a whole.

**Skills, Experiences and Characteristics Identified as Important in Selection of Directors**



Requirements for directors to have cybersecurity and human capital management skills and experiences is expected to increase.

# Women in Leadership

## Women in the C-Suite at the Top 100 Companies



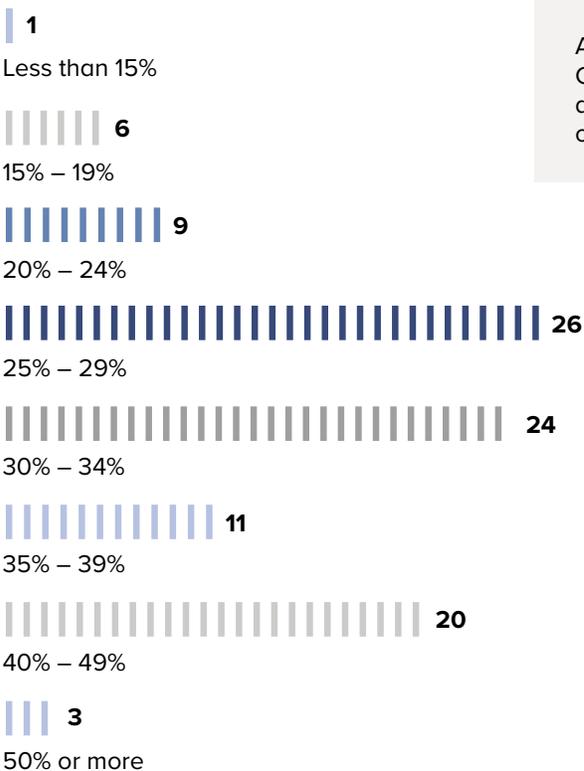
## Women in the Boardroom

Women held approximately 32% of the total number of board seats at the Top 100 Companies in 2021, up from 30% in 2020. The number of Top 100 Companies with a board comprised of 30% or more women rose from 53 companies to 58 companies over the past year. 23 of the Top 100 Companies have a board with 40% or more women members, up from 13 in 2020.



## Gender Diversity on the Board

(% of women on the board)



All of the Top 100 Companies had at least one woman on the board.

## FAST FACTS

### Average Age and Tenure

The average age and tenure of female directors is less than male directors

Age  
**63.2**  
Men

Tenure  
**8.9**  
years

Age  
**60.8**  
Women

Tenure  
**6.2**  
years

# Human Capital Management

This year was the first year that the Top 100 Companies were required to provide disclosure on human capital resources material to the company's business. It was up to each company to determine which human capital resources were material to its business. The topics chosen by the Top 100 Companies varied, as did whether the company decided to include data to supplement its disclosure.

## The Most Discussed Topics:



## Diversity, Equity & Inclusion

**60** of the Top 100 Companies discussed both gender and/or race/ethnicity, whereas only 36 of the Top 100 Companies provided data on these topics. Industries where at least 50% of the Top 100 Companies discussed gender and/or race/ethnicity include the Healthcare, Pharmaceuticals and Financial Services industries.

## Workforce Demographics

Many Top 100 Companies discussed workforce demographic topics. A larger percentage supplemented these discussions with data on topics such as number of employees, employee classification and employment location.



37 of the Top 100 Companies provided data on employment classification, with most data provided by Top 100 Companies in the Retail and Technology industries

## Employee Turnover

While only 21 of the Top 100 Companies discussed employee turnover, 15 of those provided data to supplement their disclosure, primarily from the Technology and Financial Services industries.

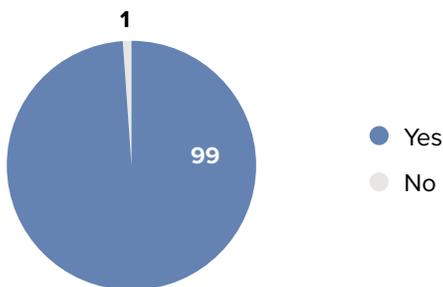
**42** of the Top 100 Companies discussed Affinity Groups

\*The data provided is for all Top 100 Companies. However, as of the date of data collection, certain Top 100 Companies have not yet filed a Form 10-K in 2021 that required compliance with the new rules on human capital disclosure. For purposes of this Survey, these companies were considered as not disclosing the identified information.

# ESG Disclosure and Governance

**99** Top 100 companies issued a CSR report

## Does the Company Issue a CSR Report?\*



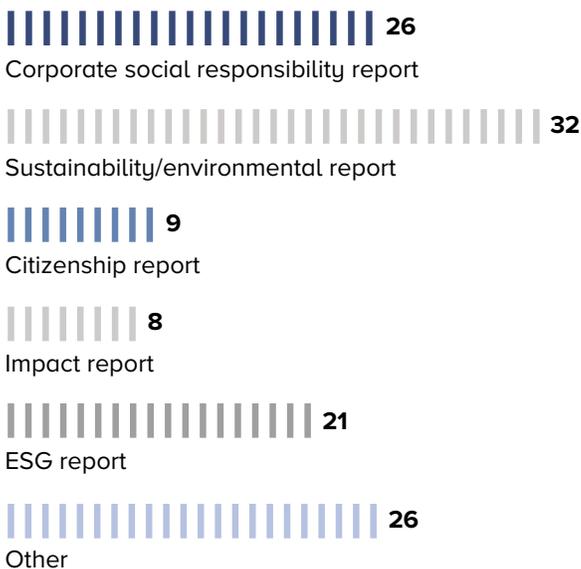
\* Three of the Top 100 Companies have ESG-dedicated websites only.

## Of the 99 Companies that Issued a CSR Report, have they Issued an Updated CSR Report for 2020?



\* Includes ESG website updates for 2020.

## Name of the CSR Report\*



\*A total of 122 reports were published by the Top 100 Companies. 81 of the Top 100 Companies published one report, 15 published two reports, one published three reports and two published four reports.

## Is the CSR Report Issued as a Single CSR Report\* or in Multiple CSR Reports?



\*ESG-dedicated websites are considered as a single report.

## Does the Company Announce the Issuance of CSR Report in a Press Release?



Of the 82 Top 100 Companies that issued an updated CSR Report for 2020, 57 identified the date of issuance of the report and

**37**  
issued their reports prior to or on the same day as their annual meeting and

**20**  
issued their reports after their annual meeting

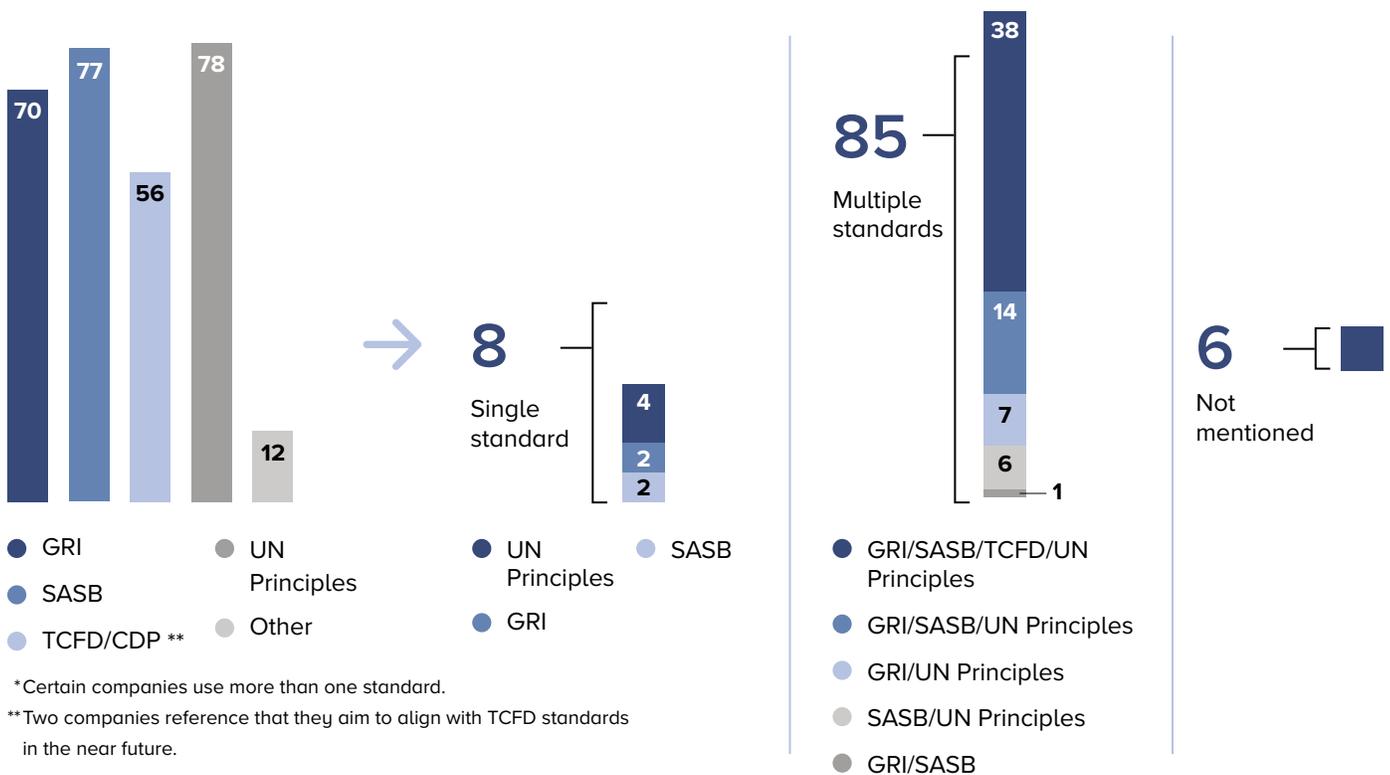
## When is this CSR Report Made Public?

**57** → Companies with CSR report date

### Publishing Timeline



## What Standards did the Company Reference in Preparing its CSR Reports\*?



Does the Company Disclose its Alignment with the United Nations' Sustainable Development Goals (SDGs)?

Yes → 75

No → 25

NO POVERTY  
1



→ 26

ZERO HUNGER  
2



→ 25

GOOD HEALTH AND WELL-BEING  
3



→ 51

QUALITY EDUCATION  
4



→ 40

GENDER EQUALITY  
5



→ 53

CLEAN WATER AND SANITATION  
6



→ 34

AFFORDABLE AND CLEAN ENERGY  
7



→ 46

DECENT WORK AND ECONOMIC GROWTH  
8



→ 58

INDUSTRY, INNOVATION AND INFRASTRUCTURE  
9



→ 37

REDUCED INEQUALITIES  
10



→ 39

SUSTAINABLE CITIES AND COMMUNITIES  
11



→ 37

RESPONSIBLE CONSUMPTION & PRODUCTION  
12



→ 48

CLIMATE ACTION  
13



→ 64

LIFE BELOW WATER  
14



→ 22

LIFE ON LAND  
15



→ 28

PEACE, JUSTICE AND STRONG INSTITUTIONS  
16



→ 24

PARTNERSHIPS FOR THE GOALS  
17

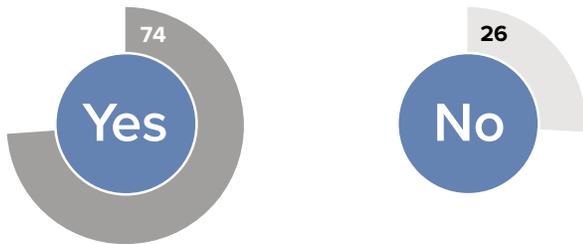


→ 35

**Does the CSR Report Contain a Letter from the CEO?**



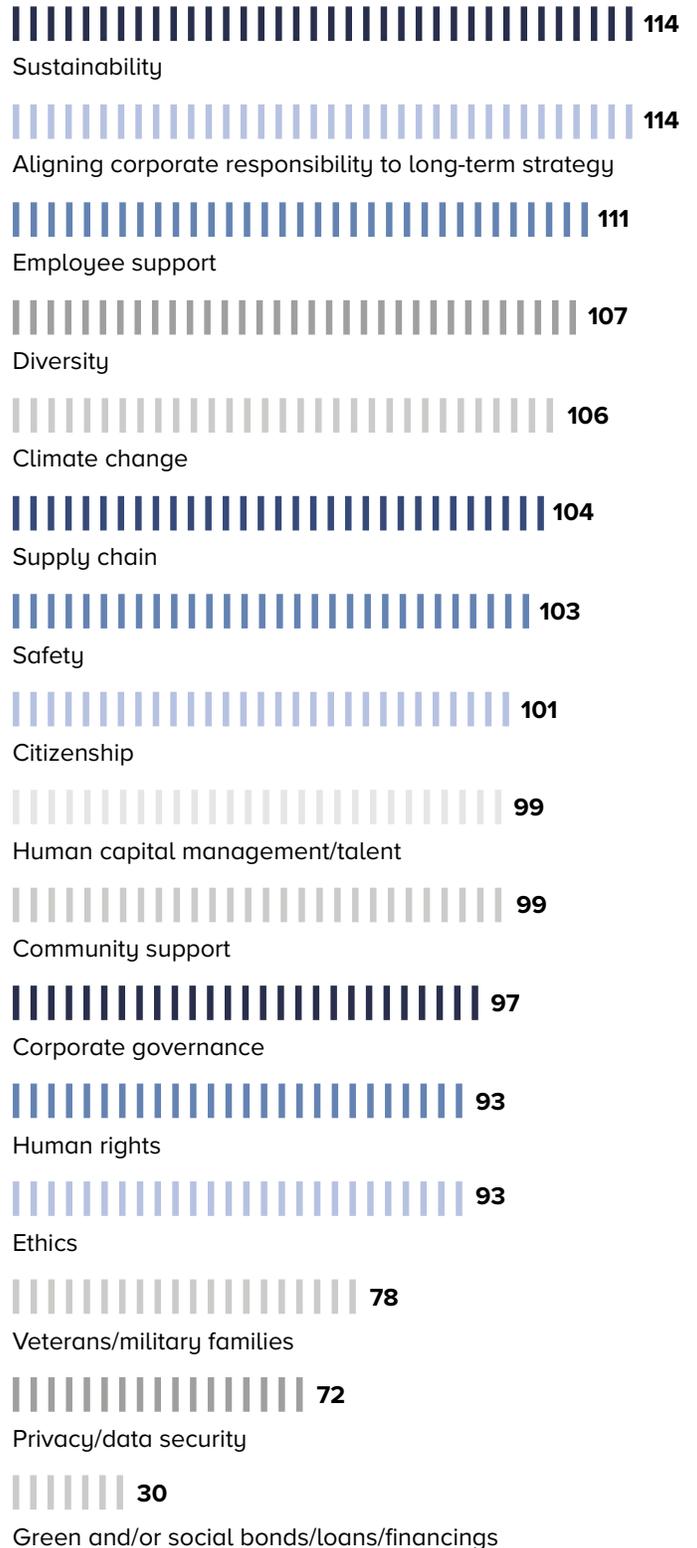
**Does the Company Have a “Chief Sustainability Officer” (or Other Officer with a Similar Title)?**



**There was a reasonable degree of consistency in the topics covered in the CSR reports of the Top 100 Companies**

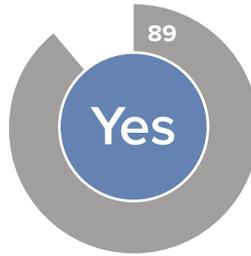


**What Topics are Covered in the CSR Report\*?**



\*Includes review of both single and multiple CSR reports issued by the Top 100 Companies.

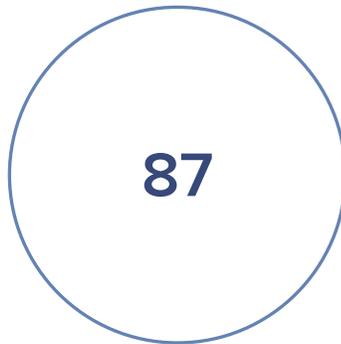
Does the Company Disclose the Board's Oversight of ESG Matters in its Proxy Statement?



How Does the Board Allocate Responsibility for ESG Oversight?



Full board



Board and committee(s)

Committees Responsible for ESG Oversight\*



Nominating and governance committee



Public policy/regulatory and compliance/sustainability committee



Audit committee



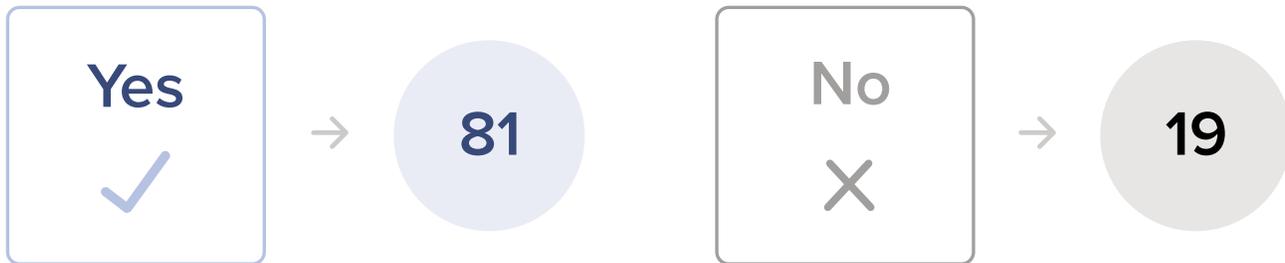
Compensation committee



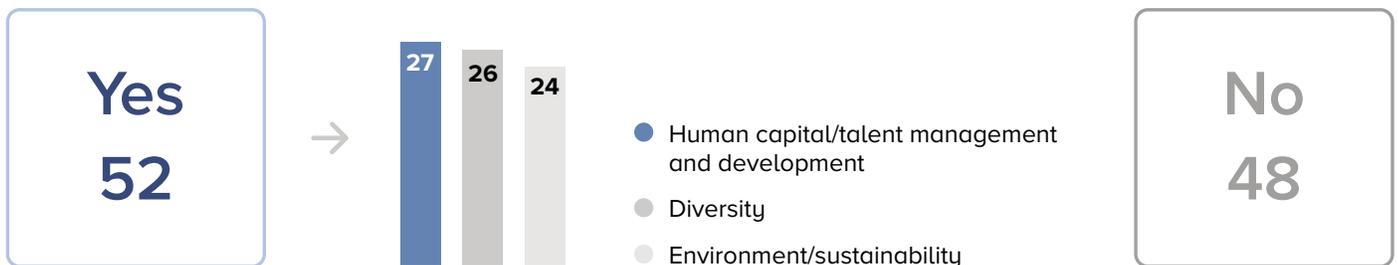
Corporate social responsibility committee

\*Based on a review of proxy statements, committee charters and corporate governance guidelines, of the 87 companies that disclosed which board committee(s) had responsibility for ESG oversight, 11 of the Top 100 Companies had two or more committees responsible for such oversight.

Is ESG Oversight Disclosed in Committee Charters or Corporate Governance Guidelines?

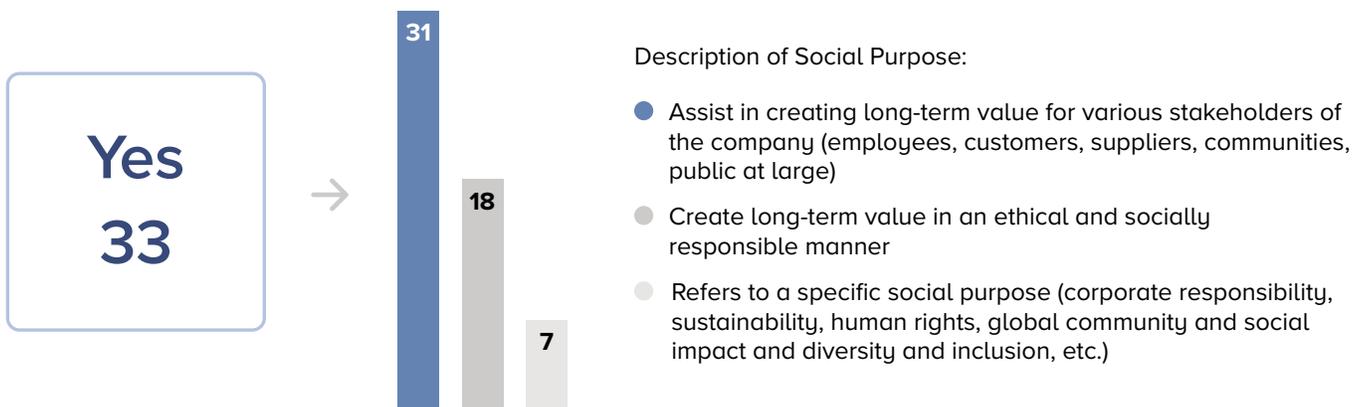


Does the Proxy Statement Identify ESG Factors as a Skill Set in the Director Skills Matrix or Narrative Description?\*



\*Some companies included more than one ESG factor as a skill set in their director skills matrix or narrative description.

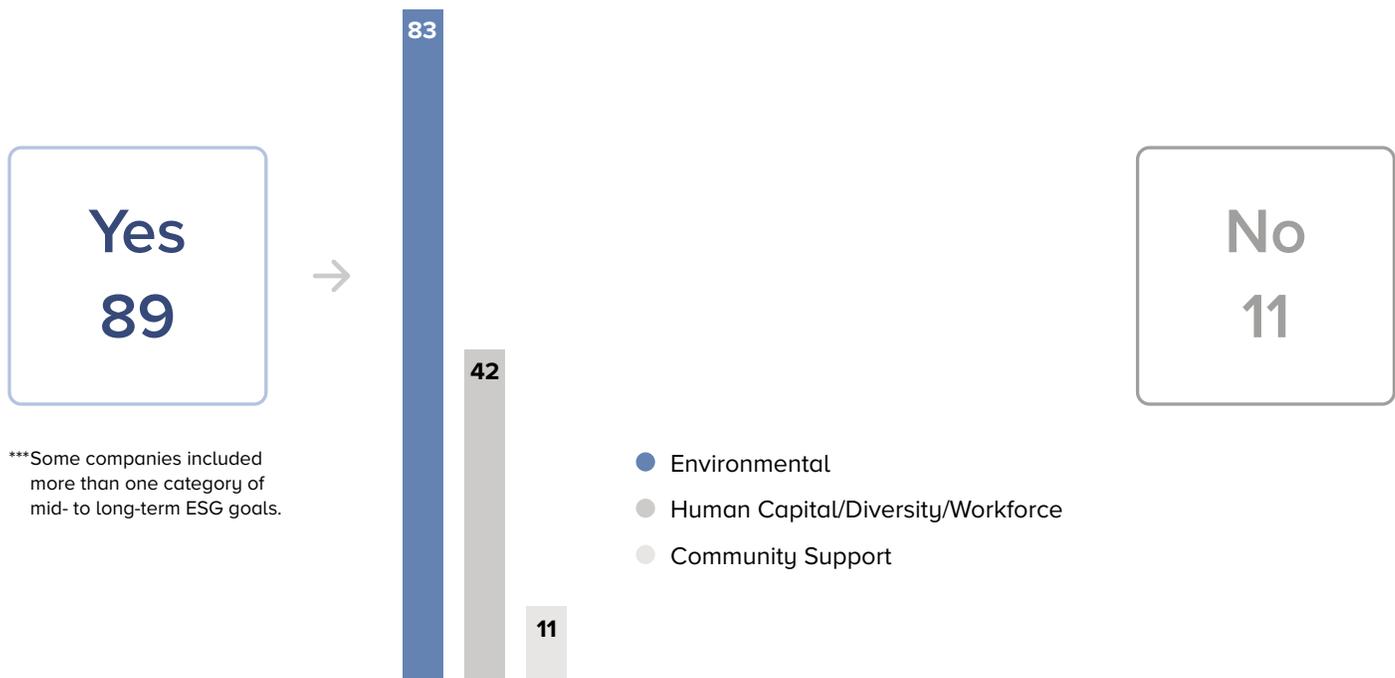
Does the Company’s Corporate Governance Guidelines State a “Social Purpose” as Being Important to the Company?\*



\*\*Some companies included more than one description of social purpose.

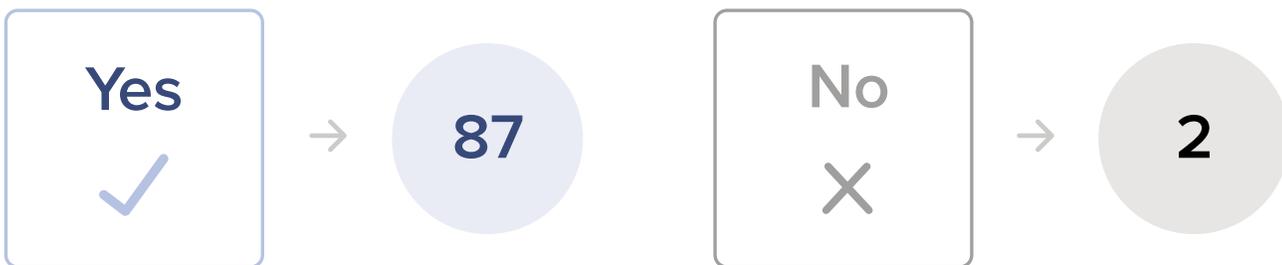
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Does the Proxy Statement or CSR Report Disclose Any Mid- to Long-Term ESG goals?\*\*\*



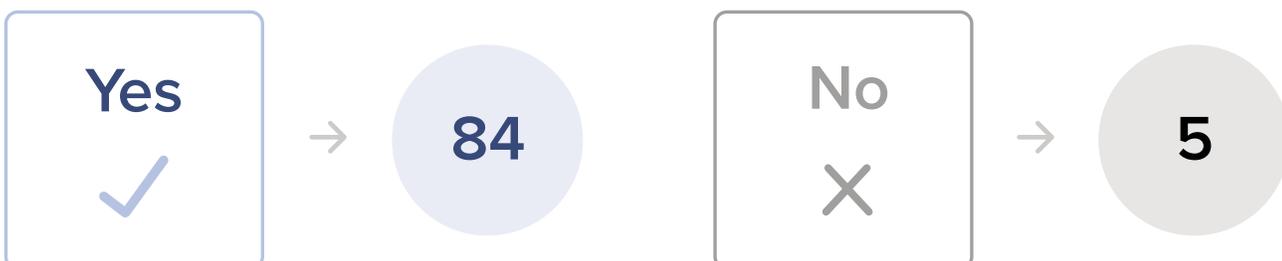
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Is a Specific Target Disclosed?



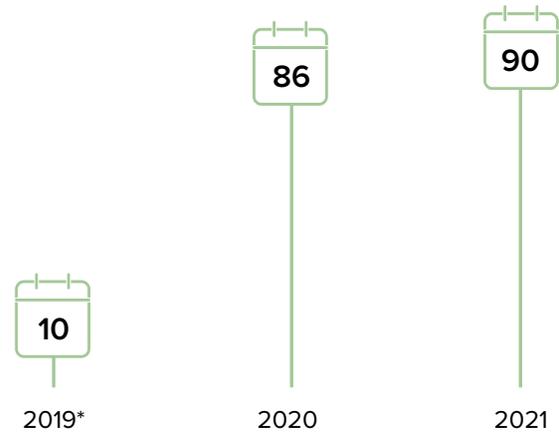
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Is a Specific Timeframe Disclosed?



# Format of Annual Shareholder Meetings

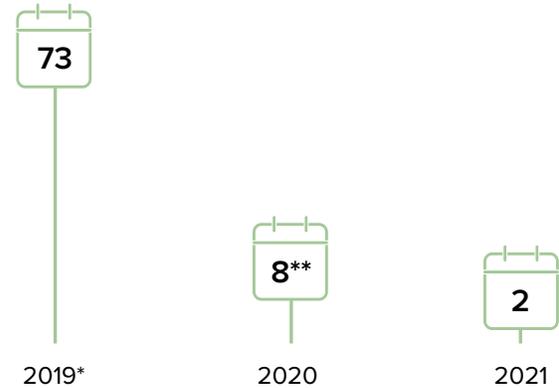
## Companies that Held Virtual Annual Meetings



## Companies that Held In-Person Annual Meetings

\*Two of the Top 100 companies did not hold an annual meeting in 2019.

\*\*Most companies with in-person meetings had their annual meetings pre-COVID-19.



## Companies that Held Both Virtual and In-Person Annual Meetings

**7** Not Yet Disclosed  
(as of August 30, 2021)



# Cybersecurity

Cybersecurity and data protection and related risk management discussions continue to be areas of focus for directors.

2019

2020

2021

## Responsibility for Cybersecurity Matters

The number of Top 100 Companies that indicated that the board and/or a board committee had responsibility for cybersecurity matters



## Directors with Cybersecurity Experience

The number of Top 100 Companies that specifically identified directors with cybersecurity or data security experience



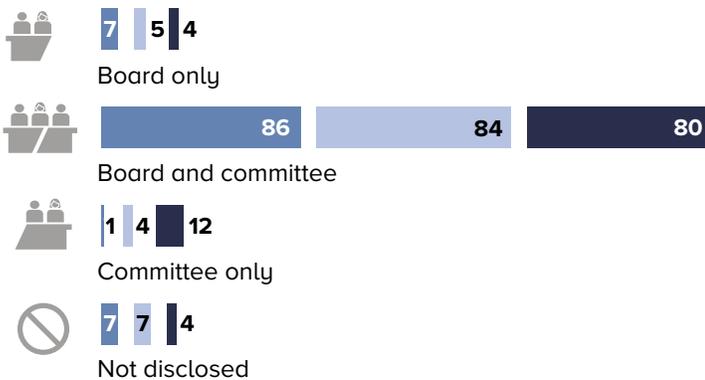
## Cybersecurity Risk Management

The number of Top 100 Companies that identified cybersecurity as part of the board's oversight role over risk management



## At the Top 100 Companies:

### Who has Responsibility for Cybersecurity and/or Data Security/Privacy?



### If a Committee is Involved, which Committee?\*



\*For several companies, responsibility for cybersecurity and/or data security/privacy is shared by two or more committees.

# IPO Governance Practices

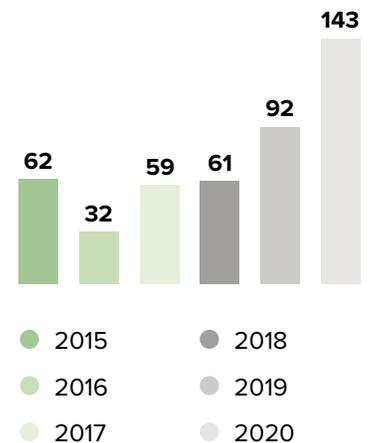
IPO companies continue to adopt the corporate governance practices that work for them, regardless of ISS voting policies.

## Comparing IPOs from 2015 to 2020

ISS initiated voting policies in 2015, updated in 2017, with respect to newly public companies, designed to influence the governance practices of companies considering an initial public offering in the United States by recommending a vote against directors of newly public companies due to the adoption of governance policies that diminish shareholder rights. We look back on our Surveys of IPO companies since 2016 to consider whether the voting policies have had a significant impact over time.

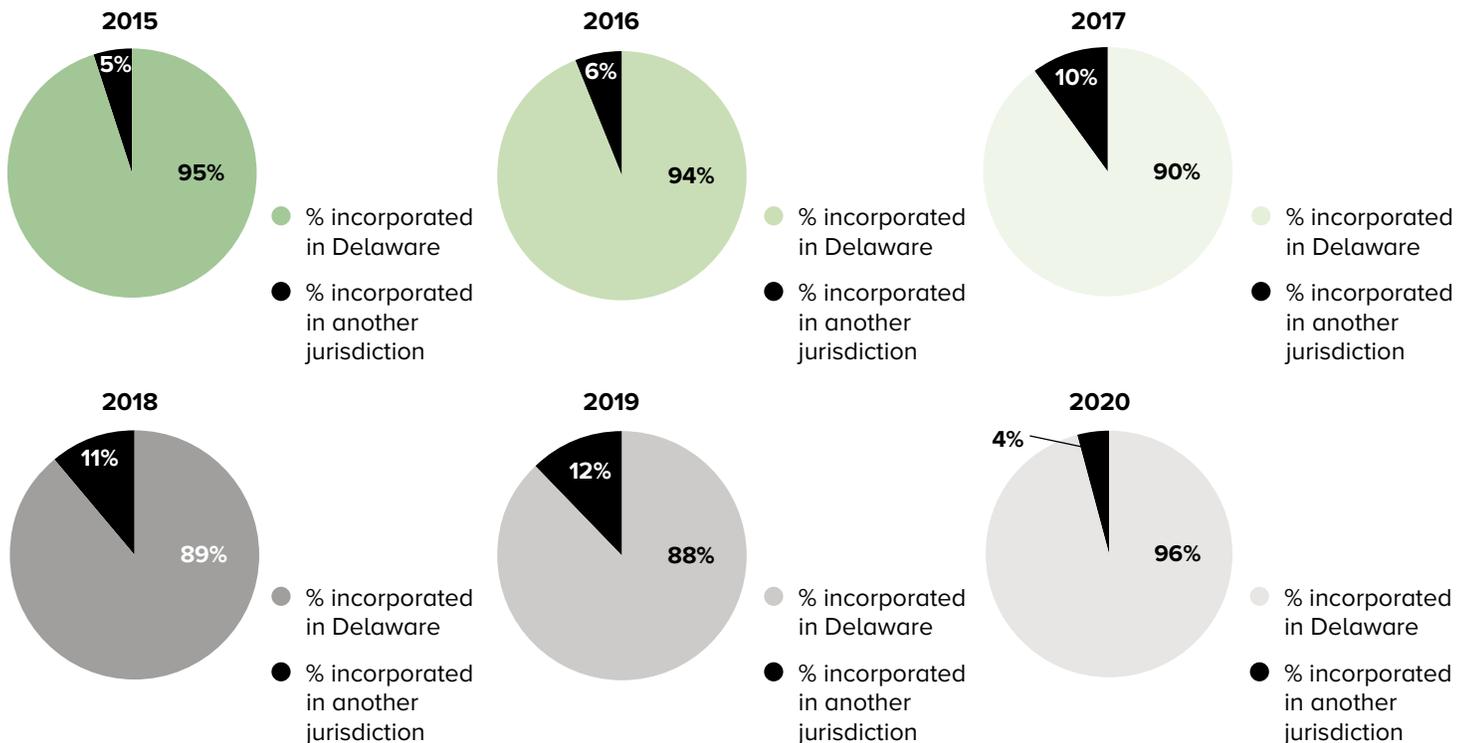
In order to evaluate the impact of the ISS policy and voting recommendations, we examined IPOs that were priced with a size of at least \$100 million to analyze governance practices that we would expect to be considered problematic by ISS. Foreign private issuers, SPACs, master limited partnerships and REITs were excluded. In 2020, most IPOs surveyed were on Nasdaq (119 out of 143). In prior years, IPOs were roughly evenly split between the NYSE and Nasdaq.

## Number of IPOs Surveyed



## State of Incorporation

Delaware continues to be the most popular state of incorporation for the IPO companies surveyed, and the percentage of Delaware-domiciled corporations in 2020 increased compared to prior years.

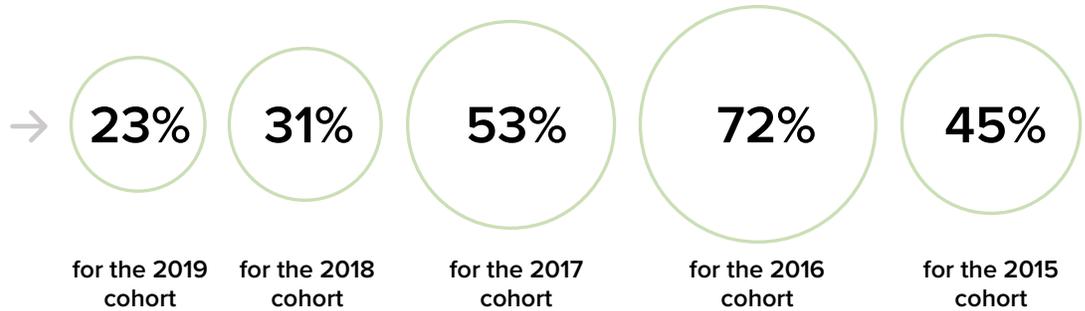


## Controlled Companies

Of the 143 companies surveyed that have conducted their IPO in 2020

**24%**

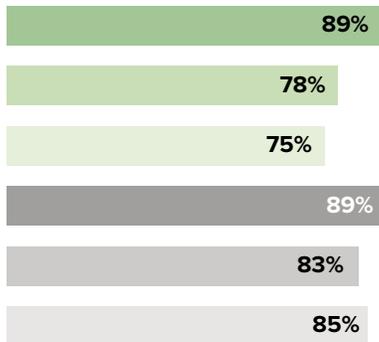
remained controlled companies after the IPO (i.e., more than 50% of the voting power was owned by a single person or group)



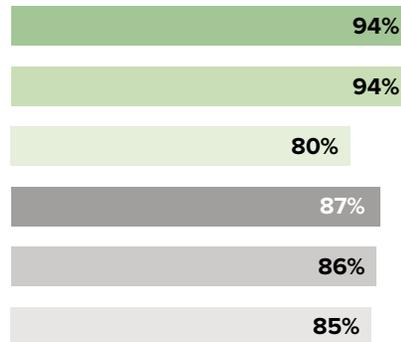
## Governance Practices Adopted by IPO Companies

● 2015 ● 2016 ● 2017 ● 2018 ● 2019 ● 2020

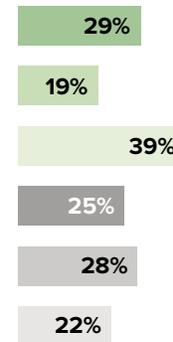
### Adopted a Classified Board



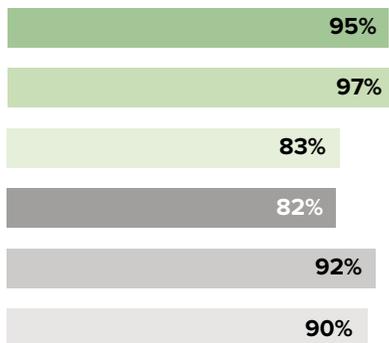
### Required a Supermajority Vote for Certain Amendments to the Certificate of Incorporation



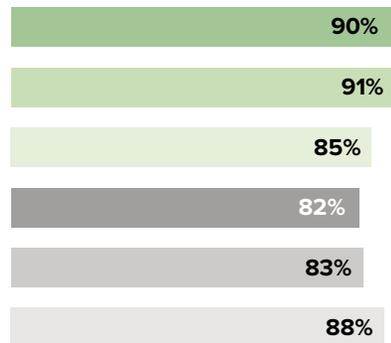
### Multi-Class Equity Structure



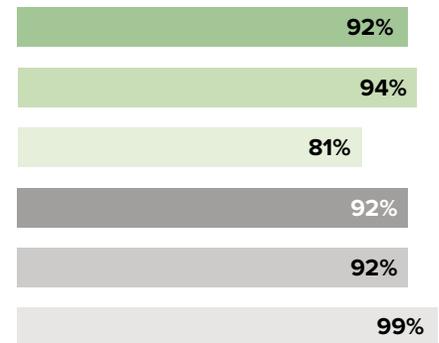
### Did Not Provide Stockholders with the Right to Call Special Meetings



### Did Not Provide Stockholders with the Right to Act by Written Consent



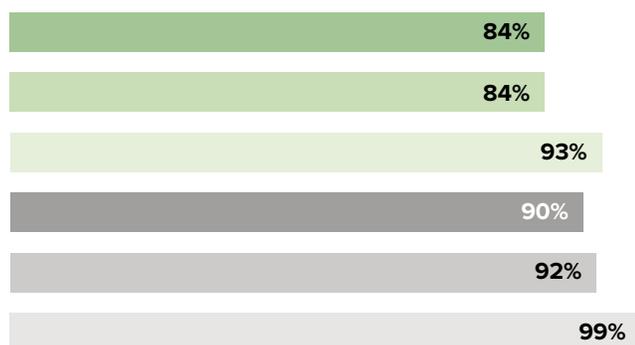
### Plurality Voting in Uncontested Director Elections



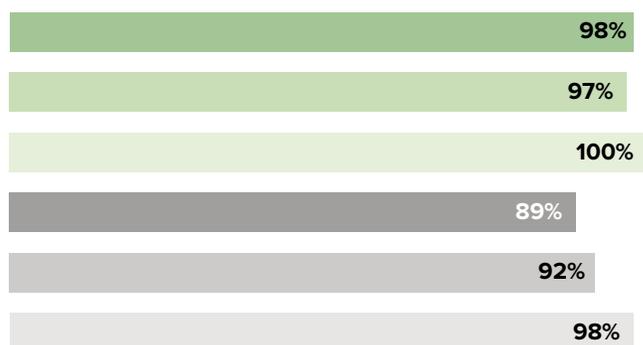
Consistent with the prior years' Surveys, many 2020 IPO companies adopted certain other corporate governance practices that may face ISS scrutiny in the future.

● 2015 ● 2016 ● 2017 ● 2018 ● 2019 ● 2020

### Adopted an Exclusive Forum Provision

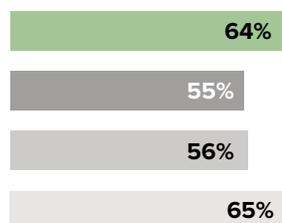


### Board Can Increase the Size of the Board Unilaterally



### Companies with Separate CEO and Chairman Roles

● 2017 ● 2018 ● 2019 ● 2020



### Conclusion

When the ISS voting policies on the corporate governance practices of newly public companies were initiated in 2015, we expected law firms and banks would initially advise IPO companies not to overreact to the then-new ISS policy, as investors have traditionally been relatively insensitive to the specifics of corporate governance practices for newly public companies. Our Survey of IPO companies from 2015 through 2020 has shown that companies continue to adopt the corporate governance practices without regard to ISS voting policies. While boards of newly public companies should be aware of ISS voting recommendations and corporate governance trends, and consider whether certain governance practices would benefit the company, boards do not seem to be overly concerned about adopting policies simply to fit within ISS voting policies.

## Equity Plans

99 of the Top 100 Companies maintain equity plans to compensate employees and non-employee directors. We highlight trends in the Top 100 Companies with regard to board discretion, non-employee director compensation and share recycling.

### Board Discretion over Performance Metrics in Equity Plans

61

Top 100 Companies permit discretion over performance metrics in the company's equity incentive plan.

### Board Discretion in Performance Awards

84

Top 100 Companies do not prohibit positive discretion for performance awards at the end of a performance period.

### Limitations on Non-Employee Director Compensation

71

Top 100 Companies include limitations for non-employee director compensation in their equity plan.

### Share Recycling

60

Top 100 Companies recycle full value awards one-for-one.

The most common limitations are (1) fair market value of equity grant, (2) number of shares granted and (3) total value of cash and equity compensation.

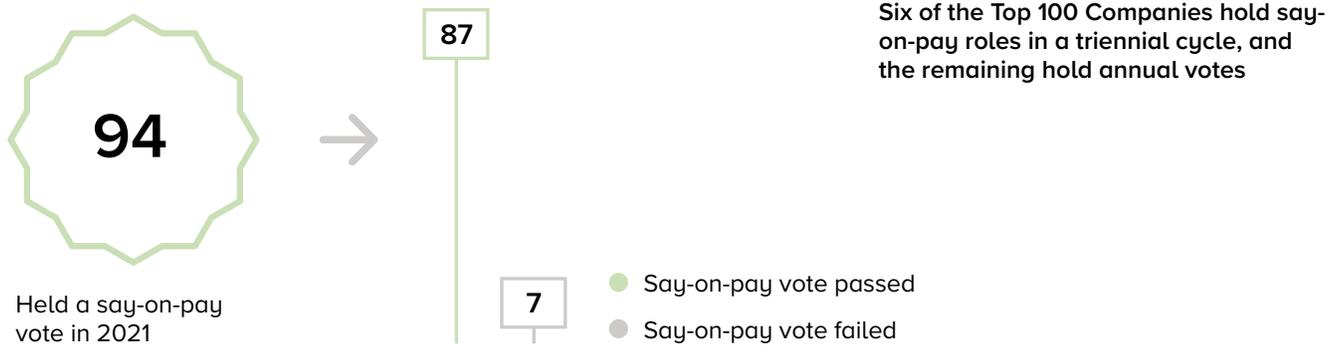
### ISS Updates Stock Ownership Guidelines for Officers and Directors

ISS credits companies that maintain stock ownership guidelines for its officers and directors. ISS announced this year that if a company's stock ownership guidelines count unearned performance awards or unexercised options (or any portion thereof), it will not count the company as having stock ownership guidelines. ISS believes that these awards should not count, as they are not actual shares owned by the individual subject to the policy.

# Say-on-Pay

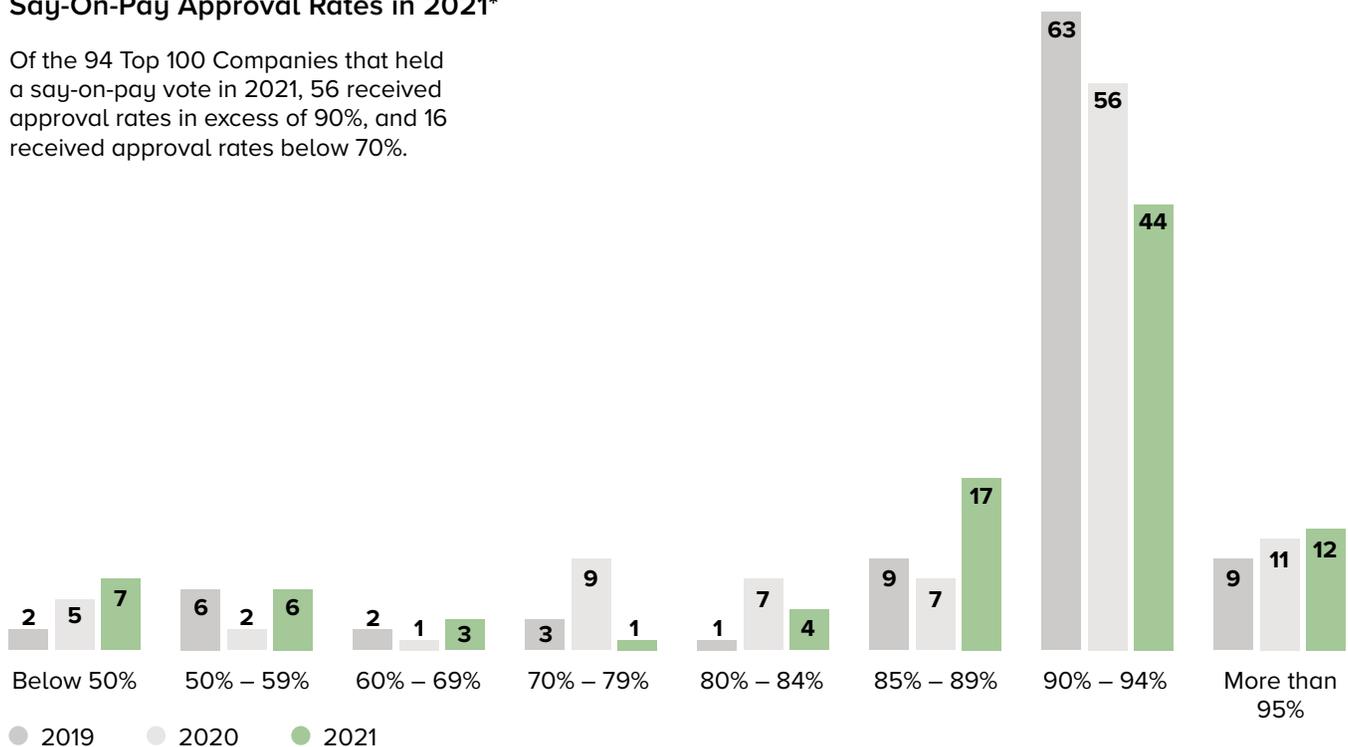
2021 represented the tenth proxy season under the Dodd-Frank Act's mandatory say-on-pay regime. Although most Top 100 Companies continue to receive high approval rates, this year saw an increase in say-on-pay failures.

## Of the Top 100 Companies



## Say-On-Pay Approval Rates in 2021\*

Of the 94 Top 100 Companies that held a say-on-pay vote in 2021, 56 received approval rates in excess of 90%, and 16 received approval rates below 70%.



\*Approval rates are calculated on the ratio of votes “for” over the sum of votes cast plus abstentions, as reported in SEC filings. Ranges include fractional percentages, so, for example, the range of 50%–59% includes all voting results from 50.00% to 59.99%.

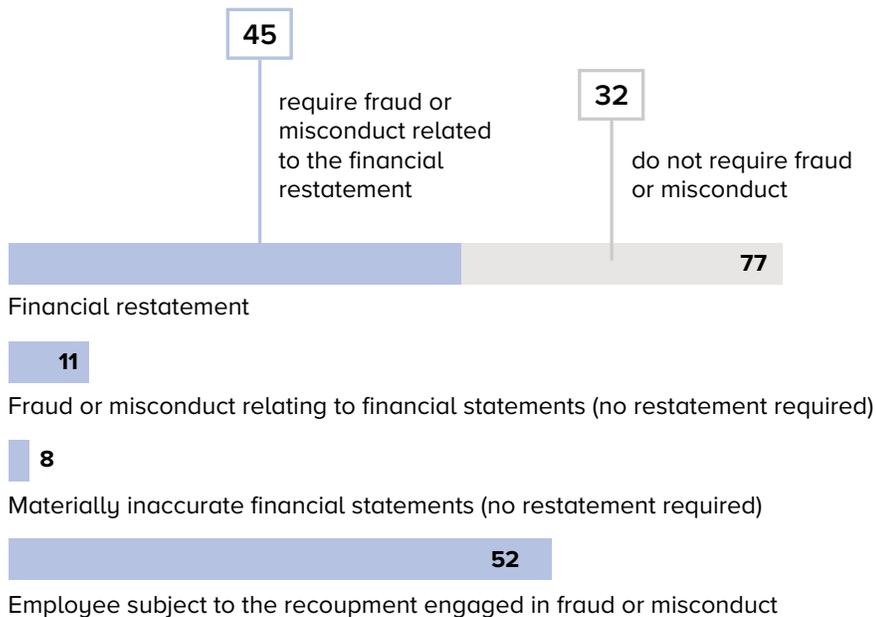
# Clawback Policies

The SEC proposed rules implementing Section 954 of the Dodd-Frank Act in 2015. In October 2021, the SEC reopened the comment period on the proposed clawback rules. Notwithstanding the lack of final rules, many Top 100 Companies voluntarily maintain clawback policies as a best practice. Their policies, however, are not uniform.

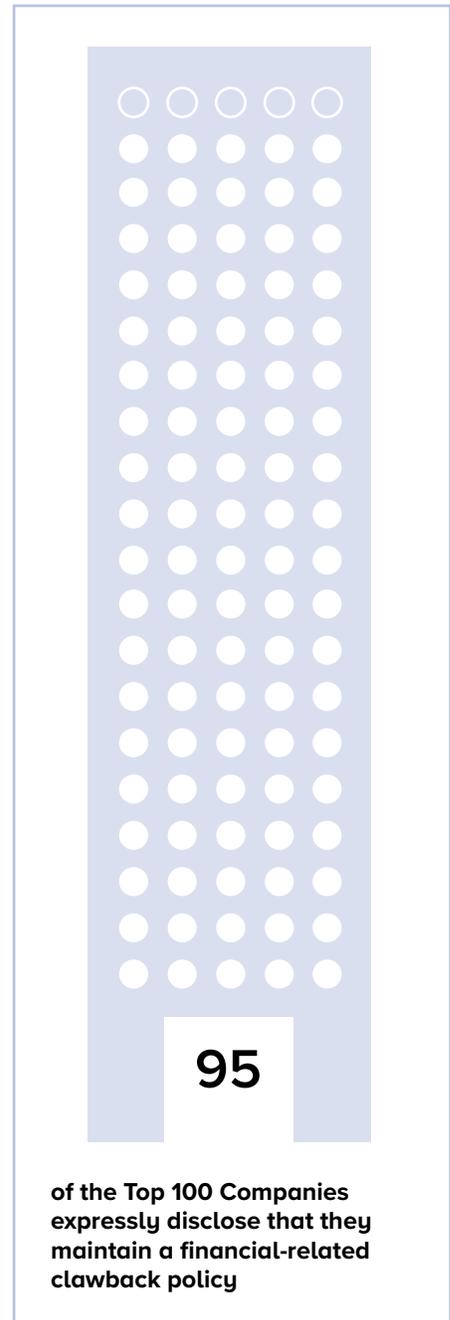
## Triggers

The Dodd-Frank Act requires recoupment of compensation upon an accounting restatement due to material noncompliance with any financial reporting requirements. The SEC's proposed rules interpret material noncompliance to mean any error that is material to previously filed financial statements. The restatement need not result from fraud or misconduct by the issuer or any of its employees.

### Triggers at the Top 100 Companies Include\*



\*Some policies of the Top 100 Companies use multiple triggering events.



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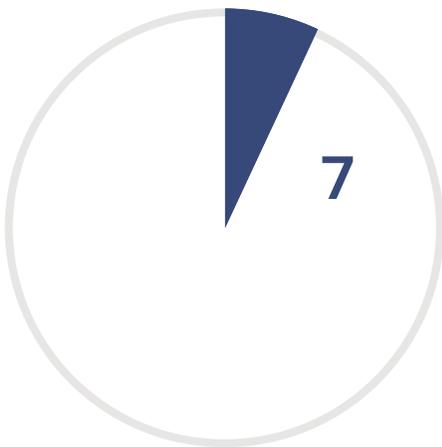
### Covered Persons

The threshold issue is determining whose compensation is subject to a clawback.

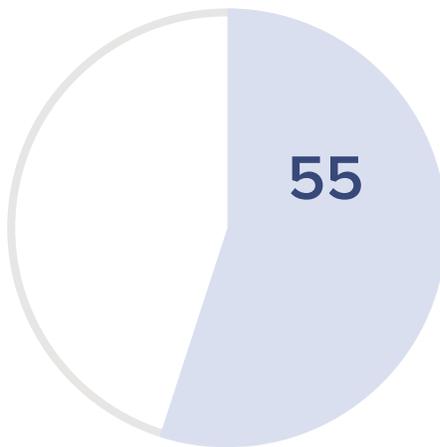


of the Top 100 Companies expressly disclose that the clawback policy applies to former employees or executives

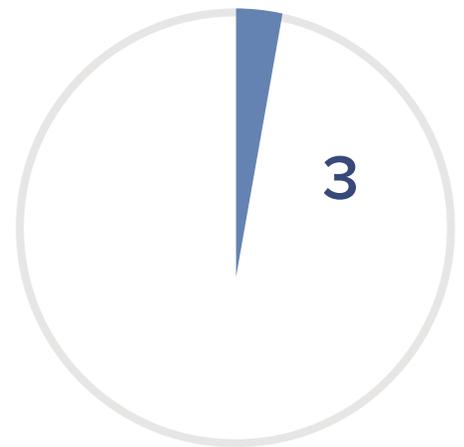
### The following individuals are subject to the voluntary financial-related clawbacks at the Top 100 Companies



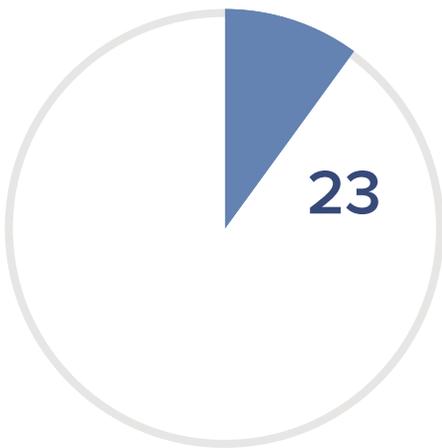
Named executive officers (NEOs) only



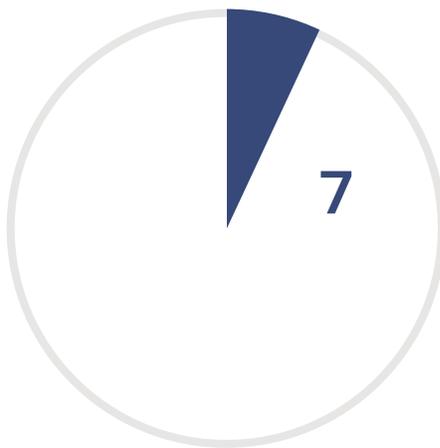
All executive officers



Section 16 officers only



All employees (or all participants in the plans or programs subject to the clawback policy)

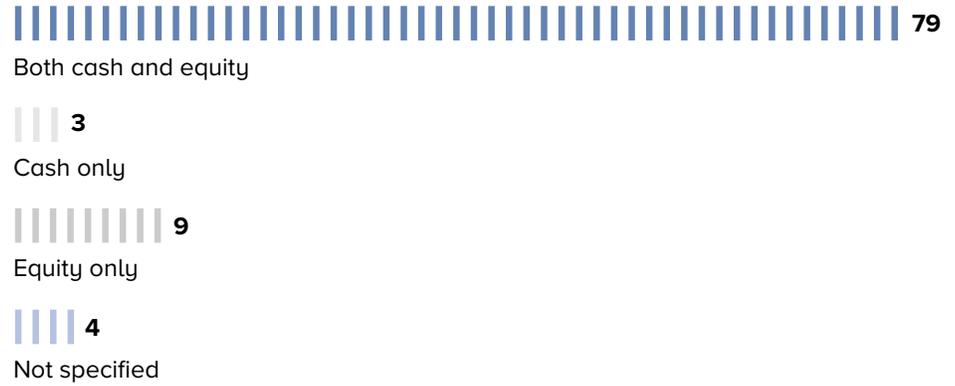


Not disclosed

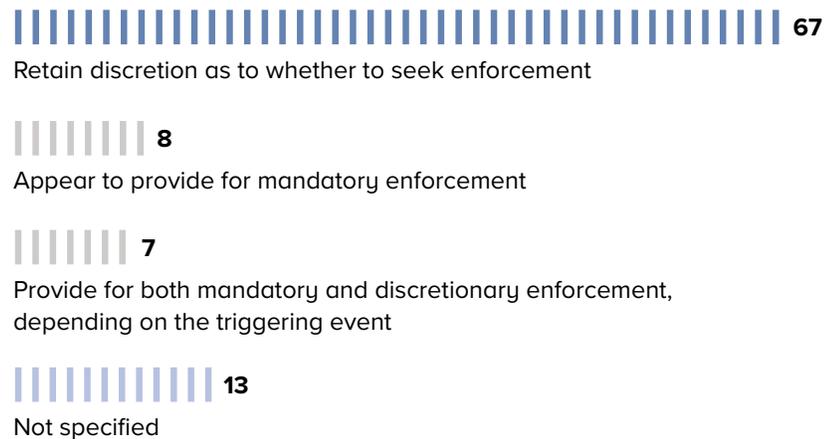
## Compensation Subject to Clawback

The Dodd-Frank Act requires companies to recover “certain incentive-based compensation (including stock options).” The SEC’s proposed rules define “incentive-based compensation” as including both cash and equity compensation, but time-vested awards are not covered. While voluntary clawback policies generally permit a company to recoup incentive compensation, the forms of incentive compensation that may be recouped vary.

### Of the 95 Top 100 Companies that Maintain a Clawback Policy, they may Recoup



### Of the 95 Top 100 Companies that Maintain a Clawback Policy

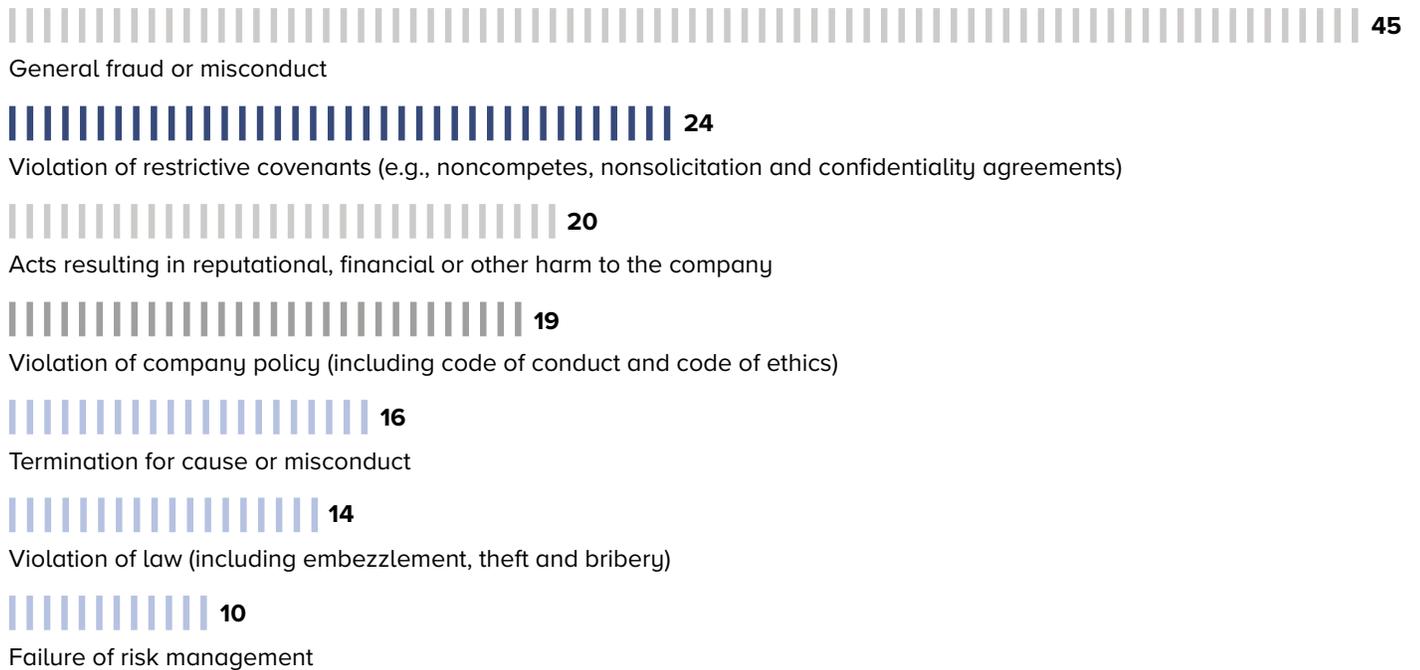




of the Top 100  
Companies publicly  
disclose that they  
maintain a detrimental  
conduct clawback policy



### Common Triggering Events for the Policies at the Top 100 Companies Include

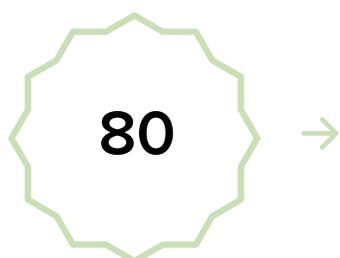
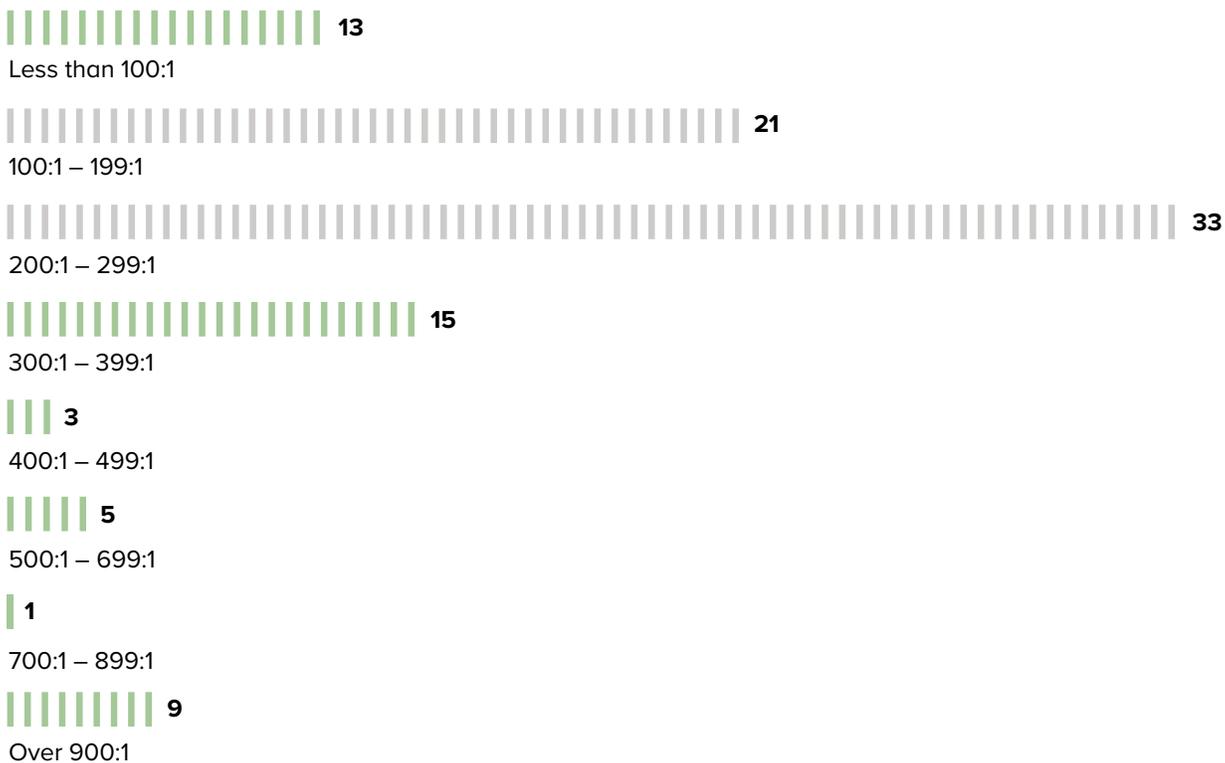


# CEO Pay Ratio

2021 represented the fourth proxy season that companies were required to disclose the ratio of CEO pay to pay of the median employee.

The CEO pay ratio rules permit companies to use the same median employee for up to three years. In its fourth season, we saw a jump in the number of companies using a new median employee.

## Pay Ratios



**80** of the Top 100 Companies used the same median employee as the prior year

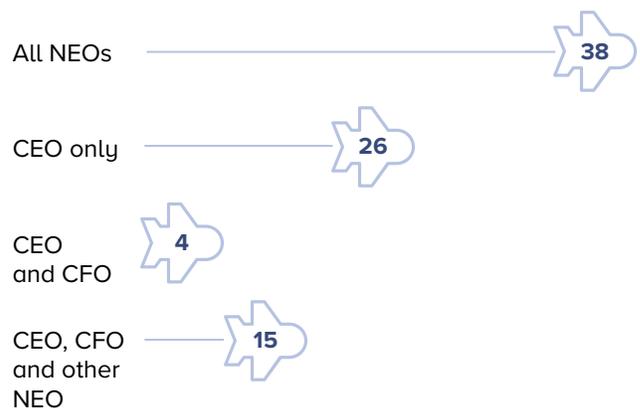
# Executive Perquisites

**95** of the Top 100 Companies provide executive perquisites

**7** of the Top 100 Companies disclosed that they provide tax gross-ups on some or all perks provided to executives



## Who is Entitled to Personal Use of Corporate Aircraft?



- 25 of the Top 100 Companies required executives to reimburse the company for all or a portion of their personal aircraft usage
- In many instances, personal usage is limited to availability and requires approval by the CEO

**While some of the perk categories showed a small decrease in the number of Top 100 Companies offering them, 2021 did not generally bring a drastic change to executive perks.**



# Golden Parachute Provisions

With the advent of say-on-pay and increased focus by institutional investors on executive compensation, golden parachute gross-up provisions have become all but obsolete at the Top 100 Companies. Many of the Top 100 Companies are implementing reduction provisions intended to protect executives from the excise tax.

## Change in Control Excise Tax Provisions

### Description of Golden Parachute Provisions Under the Code

Section 4999 of the Internal Revenue Code (the “Code”) imposes a 20% excise tax on the amount of any “excess parachute payments” received by certain executives, and Section 280G of the Code disallows an employer deduction for those payments. Any gross-up payment made in connection with the excise tax will also be subject to the excise tax and will be non-deductible. If the aggregate present value of all parachute payments paid to an executive (including cash and accelerated equity awards) equals or exceeds three times the executive’s base amount, then the executive will be considered to have received an excess parachute payment.

### Excess Parachute Payment

Code Sections 280G and 4999 are triggered if all parachute payments equal or exceed three times the executive’s base amount. The amount of the excess parachute payment that is not deductible under Section 280G, and subject to the excise tax under Section 4999, is any payment in excess of one times the executive’s base amount.

### Safe Harbor

The safe harbor is three times the executive’s base amount, less one dollar. Many companies use a 2.99 multiple in making their calculations to avoid an inadvertent trigger.

### Base Amount

An executive’s base amount is the average of his or her compensation from the employer that was includible in his or her gross income for the most recent five calendar years ended prior to the year in which the change in control occurs.

### Excise Tax Reduction Provisions

Companies are increasingly adopting measures to protect executives from the excise tax without providing tax gross-ups. The two most common measures include a “cut-back” provision and a “better-of” provision.

### “Cut-Back” Provisions

Under a “cut-back” provision, the change in control payments are automatically reduced to the safe harbor amount (or, in many instances, 2.99 times the base amount) so that no excise tax applies.

### “Better-Of” Provisions

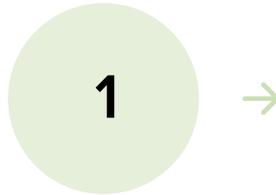
Under a “better-of” provision, employees will receive change in control payments equal to the greater of (1) the after-tax amount they would have received after the imposition of the Section 4999 excise tax and (2) the “cut-back” amount (i.e., the safe harbor).

**2** of the Top 100 Companies maintain a “cut-back” provision

**45** of the Top 100 Companies maintain a “better-of” provision

## Golden Parachute Excise Tax Gross-Ups

For the past six years, the number of companies providing “golden parachute” excise tax gross-up protection has remained small.



The gross-up is only with respect to legacy arrangements. There are no new gross-ups.

of the Top 100 Companies provides a full or modified gross-up to one or more of their NEOs



## Full Gross-Ups



## Modified Gross-Up

Under a modified gross-up, payment is only made if the change in control payments exceed a specified amount over the safe harbor. For instance, a company may provide that it will only pay a gross-up if the aggregate amount of the change in control payments exceeds the safe harbor amount, generally by 10% or more.

At some companies, if the change in control payments are below this percentage, they will be cut back to the safe harbor amount.



For the third year in a row, no Top 100 Company provides for a modified gross-up



# Survey Methodology

We reviewed the corporate governance and executive compensation practices of 100 of the largest U.S. public, non-controlled companies that have equity securities listed on the NYSE or Nasdaq. These companies were selected based on a combination of their latest annual revenues and market capitalizations and are referred to as the “Top 100 Companies.” We derived the data in this Survey from publicly available sources available as of June 1, 2021, except where otherwise noted.

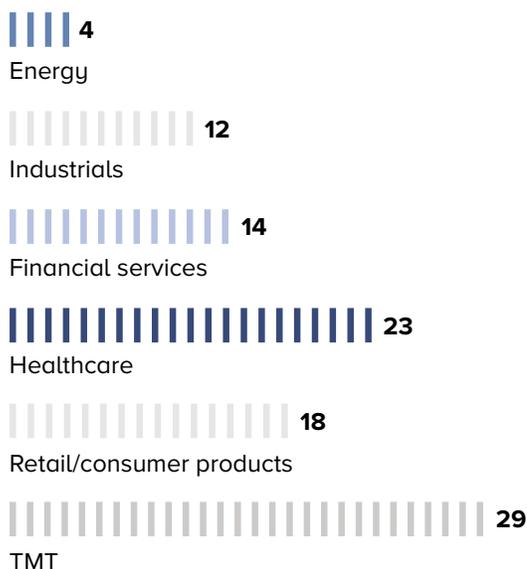
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## Industries of Top 100 Surveyed Companies



## Surveyed Documents

- Annual Proxy Statements
- Charters and Bylaws
- Board Committee Charters
- Corporate Governance Guidelines
- Corporate Social Responsibility Reports and Websites

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## Top 100 Companies Included in the 2021 Survey:

3M Company	Eli Lilly and Company	PayPal Holdings, Inc.
Abbott Laboratories	The Estée Lauder Companies Inc.	PepsiCo, Inc.
AbbVie Inc.	Exxon Mobil Corporation	Pfizer Inc.
Adobe Inc.	Facebook, Inc.	Philip Morris International Inc.
Advanced Micro Devices, Inc.	FedEx Corporation	The Procter & Gamble Company
Alphabet Inc.	Ford Motor Company	QUALCOMM Incorporated
Altria Group, Inc.	General Electric Company	Raytheon Technologies Corporation
Amazon.com, Inc.	General Motors Company	salesforce.com, inc.
American Express Company	Gilead Sciences, Inc.	Square, Inc.
AmerisourceBergen Corporation	The Goldman Sachs Group, Inc.	Starbucks Corporation
Amgen Inc.	HCA Healthcare, Inc.	Stryker Corp
Anthem, Inc.	The Home Depot, Inc.	T-Mobile US, Inc.
Apple Inc.	Honeywell International Inc.	Target Corporation
Applied Materials, Inc.	Humana Inc.	Tesla, Inc.
AT&T Inc.	Intel Corporation	Texas Instruments Incorporated
Bank of America Corporation	International Business Machines Corporation	Thermo Fisher Scientific Inc.
Berkshire Hathaway Inc.	Intuit Inc.	The TJX Companies, Inc.
BlackRock, Inc.	Johnson & Johnson	Uber Technologies, Inc.
The Boeing Company	JPMorgan Chase & Co.	Union Pacific Corporation
Bristol-Myers Squibb Company	The Kroger Co.	United Parcel Service, Inc.
Broadcom Inc.	Lockheed Martin Corporation	UnitedHealth Group Incorporated
Cardinal Health, Inc.	Lowe's Companies, Inc.	Verizon Communications Inc.
Caterpillar Inc.	Marathon Petroleum Corporation	Visa Inc.
Centene Corporation	MasterCard Incorporated	Walgreens Boots Alliance, Inc.
The Charles Schwab Corporation	McDonald's Corporation	Walmart Inc.
Charter Communications, Inc.	McKesson Corporation	The Walt Disney Company
Chevron Corporation	Merck & Co., Inc.	Wells Fargo & Company
Cigna Corporation	MetLife, Inc.	
Cisco Systems, Inc.	Micron Technology, Inc.	
Citigroup Inc.	Microsoft Corporation	
The Coca-Cola Company	Morgan Stanley	
Comcast Corporation	Netflix, Inc.	
Costco Wholesale Corporation	NextEra Energy, Inc.	
CVS Health Corporation	NIKE, Inc.	
Danaher Corporation	NVIDIA Corporation	
Deere & Company	Oracle Corporation	
Dell Technologies Inc.		

Eleven companies are new to the 2021 Survey.  
72 of the Top 100 Companies are listed on the NYSE and 28 of the Top 100 Companies are listed on Nasdaq.

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