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Key Considerations for the 2021 Reporting Season

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As public companies prepare for the 2021 reporting season, they will need to consider new SEC disclosure requirements and guidance. In addition, public companies must evaluate the impact of the COVID-19 pandemic (COVID-19), related actions to mitigate its spread, and governmental relief efforts on their business, and decide how to reflect these changes in their annual reports on Form 10-K and proxy statements. Public companies also should evaluate their diversity and inclusion efforts in light of the increased focus from state legislatures, proxy advisory firms, institutional investors, stock exchanges and the public. Below is a summary of the key considerations for the upcoming reporting season.

If you have any questions, feel free to contact the editor, authors or your Troutman Pepper relationship partner.

Table of Contents

C. Proxy Season

7. Compensation Disclosure.

8. Planning for Virtual and Hybrid Annual Shareholder Meetings.

9. Proxy Advisory Firm Voting Policy Updates.

10. Diversity Considerations.

11. D&O Questionnaire Updates.

12. Hedging Disclosure Requirements Now Applicable to Smaller Reporting Companies and Emerging Growth Companies.

A. COVID- 19

1. SEC'S COVID-19 SUPPLEMENTAL GUIDANCE REINFORCES IMPORTANCE OF HIGH-QUALITY FINANCIAL REPORTING.

On June 23, 2020, the SEC's Division of Corporation Finance (the Division) released CF Disclosure Guidance: Topic No. 9A (the Supplemental Guidance), which supplements CF Disclosure Guidance Topic No. 9 (the Original Guidance). The Supplemental Guidance provided the Division's additional views regarding operations, liquidity, and capital resources disclosures that companies should consider with respect to business and market disruptions due to COVID-19. In the Supplemental Guidance, the Division reiterated that it will continue to monitor companies' disclosures of the impacts and risks of the ongoing COVID-19 pandemic on their businesses, financial condition, and results of operations. As with the Original Guidance, the Division urged companies to actively revise and update disclosures to help investors assess the actual and future impact of COVID-19 through the lens of management. The Division noted that "[t]hese disclosures should enable an investor to understand how management and the Board of Directors are analyzing the current and expected impact of COVID-19 on the company's operations and financial condition, including liquidity and capital resources." As it did in the Original Guidance, the Division emphasized that companies should consider the impact of COVID-19 on all of their disclosures, including disclosure controls and procedures and internal control over financial reporting (ICFR). The Supplemental Guidance addressed three general topics (See https://www.sec.gov/corpfin/covid-19-disclosure-considerations for a list of questions the Division believes companies should consider when assessing their specific situation in the context of the ongoing COVID-19 pandemic):

a. *Operations, Liquidity and Capital Resources*. Companies have had to make a broad range of material operational changes in response to the effects of the pandemic, including the transition to remote-work, supply-chain and distribution adjustments, and changes related to health and safety guidelines to protect employees, contractors and customers, including in connection with transitions back to the workplace. Companies should carefully consider their obligation to disclose such substantial changes to investors. In addition, many companies have undertaken a wide range of financing activities, such as obtaining new credit facilities, accessing public and private markets, and negotiating new or modified financing programs. Since the new financing tools may include novel terms and structures, companies should provide transparent disclosures about their plans to manage short- and long-term liquidity and funding risks, especially pertaining to new risks faced by their businesses. There may be a potential discrepancy about these disclosures being included in

earnings releases but not included in Management's Discussion and Analysis (MD&A), and in such instances companies should consider whether to include these disclosures, in light of their potential materiality, in MD&A.

b. *The CARES Act*. Companies that received financial assistance and tax relief under the CARES Act in the form of loans, deferred or reduced payments, and possible refunds should consider the short- and long-term effect of that assistance on their financial condition, operations, liquidity, capital resources, appropriate disclosures *(e.g.*, MD&A and U.S. generally accepted accounting principles (GAAP) disclosures), accounting estimates and assumptions.

c. *Ability to Continue as a Going Concern*. Companies should evaluate whether the total economic effects of COVID-19 raise substantial doubt about their ability to continue as a going concern. If the adverse impact of COVID-19 raises substantial doubt about a company's ability to meet its obligations as they become due within one year after the issuance of the financial statements, management should provide appropriate disclosures in the financial statements, and outline any plans to alleviate such doubt, as required by U.S. GAAP.

In the Supplemental Guidance, the Division referred to SEC Chief Accountant Safar Teotia's Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19 with respect to accounting and auditing matters related to COVID-19 (the June OCA Statement). The June OCA Statement expands and supplements the April OCA Statement released on April 3, 2020. In particular, the June OCA Statement focused on:

a. *Significant Estimates and Judgments*. At the onset of COVID-19, many companies had to make important judgments in accounting and financial reporting matters. Companies should ensure that significant judgments and estimates are disclosed in a manner that is "understandable and useful to investors, and that the resulting financial reporting reflects and is consistent with the company's specific facts and circumstances."

b. *Disclosure Controls and Procedures and Internal Control over Financial Reporting*. Robust internal accounting controls are essential to high-quality, reliable financial reporting. Some companies adopted, or are adapting, their financial reporting processes as they respond to the changing environment. These changes may include how controls operate or can be tested, and if there is any change in the risk of the control operating effectively in a telework environment. In addition, changes to the business and additional uncertainties may result in additional risks of material misstatement to the financial statements in which new or enhanced controls may need to be implemented to mitigate such risks. If any change materially affects, or is reasonably likely to materially affect, a company's ICFR, such change must be disclosed in its quarterly report on Form 10-Q for the fiscal quarter in which it occurred (or the annual report on Form 10-K, in the case of the fourth quarter).

c. *Ability to Continue as a Going Concern*. Management should consider whether relevant conditions and events, taken as a whole, raise substantial doubt about the company's ability to meet its obligations as they become due within one year after the issuance of the financial statements. In instances where substantial doubt about a company's ability to continue as a going concern exists, management should consider whether its plans alleviate such substantial doubt and make appropriate disclosures to inform investors. Such disclosures should include information about the principal conditions giving rise to the substantial doubt, management's evaluation of the significance of those conditions relative to the company's ability to meet its obligations, and management's plans that alleviated substantial doubt. If after considering management's plans, substantial doubt about a company's ability to continue as a going concern is not alleviated, additional disclosure is required.In addition, although an auditor's review of interim financial information is not designed to identify conditions or events that indicate substantial doubt about a company's ability to continue as a going concern, the auditor may become aware of such conditions or events in the course of performing review procedures. In such cases, the auditor should inquire with management and consider the adequacy of the relevant disclosures' conformity with GAAP. After performing such procedures, to the extent the auditor determines the relevant disclosure is so inadequate that it represents a departure from GAAP, the auditor should extend the procedures, evaluate the results and communicate as appropriate with the company and its audit committee.

d. *Vital Audit Committee.* Audit committees play a key role in the financial reporting system through their oversight of financial reporting, including ICFR and the external, independent audit process. The Office of Chief Accountant intends to continue to be proactive in engaging with audit committee members to understand current market developments, as well as to solicit their perspectives on improving the oversight of financial reporting.

2. RISK FACTORS SECTION OF FORM 10-K SHOULD BE UPDATED AS THE RISKS RELATED TO COVID-19 EVOLVE.

Most public companies updated the risk factors section of their Form 10-Ks or Form 10-Qs in the spring of 2020 in light of COVID-19. As the pandemic has continued through multiple quarters, the risks that COVID-19 and the related governmental and business responses pose to public companies have evolved. As with all significant developments, public companies should update the risk factor section of their periodic reports to ensure it provides a timely discussion of all material risks related to COVID-19. As companies review and update their risk factors, they should consider the following:

a. *Actual versus Potential Risks*. Public companies should review all of their risk factors, particularly those related to COVID-19, to ensure that any risk that is described as hypothetical or potential has not in fact occurred. This has been a recent subject of SEC enforcement actions (See gov | Facebook to Pay $100 Million for Misleading Investors About the Risks It Faced From Misuse of User Data; and SEC.gov | Altaba, Formerly Known as Yahoo!, Charged With Failing to Disclose Massive Cybersecurity Breach; Agrees To Pay $35 Million). In a press release announcing the settlement of one such enforcement action, the SEC stated that "[p]ublic companies must identify and consider the material risks to their business and have procedures designed to make disclosures that are accurate in all material respects, including not continuing to describe a risk as hypothetical when it has in fact happened."For example, if a public company has stated in its risk factors section that COVID-19 could cause the company to temporarily close its offices, plants, or warehouses, it must ensure that COVID-19 has not in fact caused any such closure. If COVID-19 has caused the company to temporarily close any facilities, it should revise the risk factor to state that COVID-19 has caused the company to temporarily close certain facilities, and could cause additional closures in the future.Further, every public company should adopt disclosure controls and procedures that ensure that those responsible for reviewing and updating the risk factors have access to information necessary to assess the company's risk profile.
b. *Statements in MD&A and Investor Materials*. When reviewing and updating the risk factors section, public companies should consider the disclosure included in the other parts of the Form 10-K and in other investor materials.For example, if earnings estimates or other forward-looking statements are premised on the effective delivery of COVID-19 vaccines, the company should ensure that it includes meaningful cautionary language in its forward-looking statement disclaimer and in the risk factors section regarding risks related to the adoption, efficacy and deployment of the COVID-19 vaccines.
c. *Relation of COVID-19 to Existing Risks*. When updating the risk factors section, a public company should consider how COVID-19 and related governmental and business responses have impacted the existing risks to the company. For instance, many public companies disclose risks related to data security. Companies should consider whether to update such a risk factor to disclose the heightened risks of a data breach in a work-from-home environment.

3. USING NON-GAAP FINANCIAL MEASURES TO DISCUSS THE EFFECTS OF COVID-19.

As discussed above, on March 25, 2020, the Division published the Original Guidance, which addressed certain SEC disclosure considerations regarding the impact of COVID-19 and related business and market disruptions. In this guidance, the SEC Staff stated that: (i) the requirements of Item 10(e) of Regulation S-K, Regulation G, and the SEC Staff Non-GAAP compliance and disclosure interpretations apply to non-GAAP financial measures with adjustments caused by COVID-19; and (ii) to the extent a public company presents a financial measure that has been adjusted for the impact of COVID-19, it should disclose "why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations." This guidance acknowledged that a public company can present adjusted financial measures that show certain impacts related to COVID-19, as long as those adjustments comply with existing SEC regulations and interpretations.

As the COVID-19 pandemic extended into multiple quarterly periods, some investors and accounting professionals questioned the recurring nature of "non-recurring expenses" related to COVID-19 (See Companies Adjust Earnings for Covid-19 Costs, but Are They Still a One-Time Expense? – WSJ). In April 2020, EY's Professional Practice Group published guidance on how to appropriately use non-GAAP measures to discuss the effects of COVID-19. In this guidance, EY provided a framework that public companies can use to evaluate whether COVID-19 adjustments are acceptable for non-GAAP measures. According to the framework, non-GAAP measures that are adjusted for the effects of COVID-19 should generally exclude only items that are directly attributable to the pandemic, and are both: (i) incremental to charges incurred before the outbreak, and not expected to recur once the crisis has subsided and operations return to normal; and (ii) clearly separable from normal operations. This framework allows public companies to adjust financial measures for COVID-19-related expenses over multiple quarters, provided that the requirements of the framework are satisfied. This guidance also provided examples of adjustments that are generally consistent with the framework (*e.g.*, hazard pay, cleaning and disinfecting costs, and contract termination fees) and examples of adjustments that should be avoided (*e.g.*, cost of idled employees and rent on idled facilities). Many public companies have used this framework to determine whether adjustments to non-GAAP financial measures related to COVID-19 are permissible.

In addition to considering the EY framework in analyzing potential adjustments to financial measures, public companies should also adjust non-GAAP financial measures for non-recurring gains in addition to non-recurring expenses. For example, if a public company received governmental assistance or insurance payouts related to COVID-19, it should consider whether to adjust non-GAAP financial measures for such gains.

B. Additional Form 10-K Considerations

4. MODERNIZATION OF REG. S-K DISCLOSURE REQUIREMENTS.

On August 26, 2020, the SEC modernized the disclosure requirements in Items 101 (Description of Business), 103 (Legal Proceedings), and 105 (Risk Factors) of Regulation S-K, reflecting the first significant revisions to these disclosure items in more than 30 years. These new principles-based rules: (i) provided additional flexibility for companies to craft their business description to their particular circumstances; (ii) reduced, and in certain instances, eliminated disclosures that are not material to an investor's understanding of a company's business or legal proceedings; and (iii) provided for more organized and tailored risk-factor disclosure, including a summary section if risk factor disclosures exceed 15 pages. The amended rules added a requirement for disclosure of human capital resources, including any human capital measures or objectives a company focuses on in managing its business, to the extent material. The SEC adopted these amendments in part to improve the readability of disclosure documents by discouraging repetition and disclosure of immaterial information, and to simplify compliance efforts for companies.

a. *Item 101(a) (General Development of Business)*. Revised Item 101(a) requires principles-based disclosure of information material to an understanding of the general development of the business. Instead of a five-year timeframe, revised Item 101(a) provides companies a materiality framework, which may include the following topics: (i) material changes to a previously disclosed business strategy (a company that currently provides disclosure of its business strategy must discuss material changes or updates to the strategy); (ii) material bankruptcy or similar proceedings; (iii) material reclassification, merger or consolidation; and (iv) material acquisitions or dispositions outside of the ordinary course. In filings made after a company's initial registration statement, the company may provide only an update of the general development of its business focused on material developments that have occurred since its most recent registration statement or report that includes a full discussion, which must be incorporated by reference and, when read together with the update, would

contain the full discussion. This approach requires companies to incorporate by reference the earlier disclosure into the updated filing by including one active hyperlink to one previous filing that contains the full discussion of the general development of the business, and prohibits the use of multiple hyperlinks to prior filings. Most companies will likely continue to include a complete discussion of the development of their businesses.

b. *Item 101(c) (Narrative Description of Business)*. Revised Item 101(c) replaced the previous list of specific disclosure items with a non-exclusive list of topics drawn in part from topics formerly contained in Item 101(c). Item 101(c) also refocused the regulatory compliance disclosure requirement by including as a topic all material government regulations, not just environmental laws. Revised Item 101(c) also deleted the explicit references in the previous version of Item 101(c) to: (i) disclosure about new segments; (ii) the dollar amount of backlog orders; and (iii) working capital practices (noting that working capital is to be discussed in the MD&A if material).

c. *Item 101(c) Human Capital Disclosure*. Revised Item 101(c) now requires, to the extent such disclosure is material, a description of a company's human capital resources, including any human capital measures or objectives that the company focuses on in managing its business. The Item also requires a company to disclose, to the extent material, the number of persons employed by the company. For example, if a measure of a company's part-time employees, full-time employees, independent contractors and contingent workers, and employee turnover, in all or a portion of the company's business, is material, the company must disclose this information. Because the SEC adopted a principles-based approach, "human capital" is not defined. The SEC believes "this term may evolve over time and may be defined by different companies in ways that are industry specific." The final rule identifies various human capital measures and objectives that address the attraction, development, and retention of personnel as non-exclusive examples of subjects that may be material, depending on the nature of the company's business and workforce. The SEC indicated that each company's disclosure must be tailored to its unique business, workforce, and facts and circumstances.While Item 101(c) does not require a company to use a disclosure standard or framework to provide human capital disclosure, the SEC believes a principles-based approach affords a company the flexibility to provide disclosure in accordance with some or all of the components of any current or future standard or framework that facilitates human capital resource disclosure. Then-SEC Chairman Clayton stated that he "expect[s] to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs" and that "[a]s 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 definitions of those metrics." If not already covered, companies should consider amending their compensation or other committee (such as a committee that expressly addresses environmental, social, and governance (ESG) or corporate social responsibility (CSR) matters) charters to oversee human capital management and related disclosures.

d. *Item 103 (Legal Proceedings)*. Item 103 now permits the required information to be provided by hyperlink or cross-reference to legal proceedings disclosures located elsewhere in the document (such as MD&A, risk factors or the notes to the financials) to avoid duplicative disclosure. In addition, it increases the disclosure threshold for certain governmental environmental proceedings resulting in monetary sanctions from $100,000 to $300,000, but affords an issuer some flexibility by allowing a company, at its election, to select a different threshold that it determines is reasonably designed to result in disclosure of material environmental proceedings, provided that the threshold does not exceed the lesser of $1 million or 1 percent of the current assets of the company.

e. *Item 105 (Risk Factors)*. Item 105 now requires summary risk factor disclosure of no more than two pages if the risk factor section exceeds 15 pages. We believe this summary list is satisfied by using the bullet summaries often included in the forward-looking statements section. Item 105 now requires disclosure of "material" risk factors that make an investment in the company speculative or risky (rather than the "most significant" risks). The SEC believes changing the standard from "most significant" to "material" risks will focus companies on disclosing the risks to which reasonable investors would attach importance in making investment or voting decisions. In addition, the risk factors must be organized under relevant headings in addition to the subcaptions previously required (but not specifying the headings that should be used), with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factors section under the separate caption "General Risk Factors."

f. *November 5, 2020, Transitional FAQs*. The SEC Staff provided three clarifying FAQs regarding the new Reg. S-K modernization rules.
   i. If a company files a prospectus supplement to a Registration Statement on Form S-3 that became effective

before November 9, 2020, then the prospectus supplement does not need to comply with new Items 101 and 103. This is because Form S-3 does not expressly require Item 101 or Item 103 disclosure but rather requires the incorporation by reference from Exchange Act reports containing that information. In such cases, before filing the Form 10-K that complies with the new rules, a company is not required to amend its Form 10-K that is incorporated by reference into the Form S-3 to comply with new Items 101 and 103. Despite the fact that Item 3 of Form S-3 expressly requires Item 105 disclosure, however, the SEC Staff will not object if the prospectus supplement complies with previous Item 105 until the next update to the Registration Statement on Form S-3 for Section 10(a)(3) purposes.

ii. The new rules did not change Item 1 of Form 10-K, which only requires disclosures regarding the development of a company's business for the fiscal year covered by the Annual Report on Form 10-K.

iii. A company is not always required to provide a full discussion of the general development of its business pursuant to Item 101(a) in a Form 10-K or registration statement that requires Item 101 disclosure. As described in (a) above, for a filing other than an initial registration statement, Item 101(a)(2) permits a company to omit the full discussion of the general development of its business if it complies with the requirements allowing it to do so. A company is not required to use this updating method, and the SEC Staff anticipates that the updating method will apply mainly to registration statements.

5. SEC PERMITS THE USE OF ELECTRONIC SIGNATURES.

Effective December 4, 2020, the SEC permits the use of electronic signatures for many SEC filings, including Form 10-Ks, Form 10-Qs, Form 8?Ks, Section 16 reports, Schedules 13D and 13G, and public offering registration statements. Since the advent of electronic SEC filings through EDGAR in the 1990s, the SEC has required filings to bear signatures that appear in "conformed" (or typed) form within the electronic filing. Before this rule change, the SEC has required signatories of EDGAR filings to also manually sign the corresponding signature page to authenticate the conformed signature.

The requirement for manual signatures has been eliminated for eligible SEC filings that have been electronically signed according to the criteria established by the new rule. Before the initial electronic signature of any signatory is used in a filing, the signatory must manually sign a document attesting that he or she agrees that the use of an electronic signature in any authentication document (*i.e.*, an SEC filing that bears a conformed signature) is the legal equivalent of his or her manual signature. Thereafter, signatories will be permitted to use electronic signatures in eligible authentication documents if the electronic signature process:

- Requires the signatory to present a physical, logical or digital credential to authenticate the signatory's identity;
- Reasonably provides for non-repudiation of the signature;
- Provides that the signature be attached, affixed, or associated with the signature page/document; and
- Includes a timestamp to record the date and time of the signature.

Electronic signature services currently available, including DocuSign and Adobe Sign, are widely considered to satisfy all of those criteria. As a result, public companies and others may have their eligible SEC filings signed by officers, directors and other signatories electronically using available electronic signature services, eliminating the procedural and administrative burdens associated with collecting manually signed signature pages.

6. NEW PCAOB REQUIREMENTS REGARDING AUDITING ESTIMATES AND USE OF SPECIALISTS.

In November 2020, the Public Company Accounting Oversight Board (PCAOB) released a new Audit Committee Resource "New PCAOB Requirements Regarding Auditing Estimates and Use of Specialists." The PCAOB regulates accounting firms that audit public companies, and periodically publishes Audit Committee Resources,

which are intended to educate audit committees of public companies, but are not themselves rules or regulatory authority.

Historically, three different standards applied to accounting estimates, including fair value measurements. In addition, many public companies use specialists to develop accounting estimates, including estimates used in fair value measurements. These specialists may be employed by the public company or may be an outside provider engaged by the public company. In 2018, the PCAOB amended its standards: (i) for accounting estimates, focusing auditors on estimates with a greater risk of material misstatement, and including a new requirement that auditors need to apply professional skepticism, including addressing potential management bias, when auditing accounting estimates; and (ii) for specialists, by adding new requirements that better reflect how an auditor uses the work of specialists, as well as strengthening the requirements for evaluating the work of a company's specialist. The amendments are effective for audits of fiscal years ending on or after December 15, 2020.

The November 2020 Audit Committee Resource informs audit committees of the 2018 amendments and that as a result, the process and certain standards used by an accounting firm in preparing the annual audit of a public company have changed. Among other things, the amendments require the accounting firm to address potential management bias and to obtain an understanding of and assess both the knowledge, skill, and ability of a specialist used by a public company in preparing its financial statements, and the relationship to the company of the specialist. As a result, the accounting firm may require information from the company that was not required in previous audits, although the PCAOB noted that some accounting firms, in particular larger accounting firms, may already have been requiring that such information be provided.

The Audit Committee Resource includes sample questions regarding the new accounting estimates and specialist review processes that an audit committee may ask of management and the company's auditor.

C. Proxy Season

7. COMPENSATION DISCLOSURE.

The impacts of COVID-19 brought significant compensation challenges to many companies. When preparing the Compensation Discussion and Analysis (CD&A) for the 2021 proxy statement, public companies should expect additional scrutiny of their executive compensation decisions, and be mindful of the SEC Staff's continued focus on perks disclosures, including during COVID-19.

a. *COVID-19-Related CD&A Disclosure.*A well-drafted CD&A is an opportunity for a public company to describe how those decisions support the business goals of the company and its investors, particularly in a difficult business environment. While companies should always avoid generic or boilerplate CD&A disclosure, it will be especially important in the 2021 proxy statement to describe the rationale for specific changes to 2020 compensation. Companies should also consider addressing topics they may not normally cover. While the CD&A focuses on compensation of the named executive officers, public companies may want to consider expanding that discussion in 2021 to address the impact of the compensation program – and any changes in that program – on non-executive employees, investors and other stakeholders to provide additional context for the executive compensation decisions, particularly if the compensation program included human capital management elements, such as employee health and safety.
b. *Changes to Incentive Compensation.*If a public company made COVID-19-related or other changes to incentive compensation programs or awards during 2020, or applied discretion after the performance period to adjust payouts, its CD&A should describe those actions and provide a thoughtful explanation of why they were appropriate. Stakeholders may be more likely to appreciate the need for COVID-19-related adjustments to

annual cash bonuses and other short-term incentives, while being less understanding of in-flight changes to multi-year equity awards and other long-term incentives.A public company should consider the views of institutional investors and proxy advisory firms regarding changes to incentive compensation programs or awards, and be prepared to spend additional time drafting disclosure that tells the company's compensation narrative effectively.

Institutional Shareholder Services (ISS) released a series of FAQs in October 2020 providing its initial guidance on COVID-19-related compensation decisions in the context of the ISS pay-for-performance qualitative evaluation.

c. *Evaluating Perks.*The SEC Staff issued a new Compliance and Disclosure Interpretation (C&DI 219.05) in September 2020 to advise public companies that the traditional two-prong test for determining whether or not a benefit is a perk continues to apply, even in the midst of COVID-19. If a benefit is "integrally and directly" related to the performance of an executive's (or director's) duties, it is not a perk. A cell phone, for example, is generally not considered a perk, because it is a necessary tool for today's executive. If, however, the benefit is not integrally and directly related to performing the individual's duties, and it confers a benefit that has a personal aspect, it is a perk, unless the benefit is made generally available on a non-discriminatory basis to all employees. The fact that the benefit is provided for a business reason or for company convenience is not relevant to the analysis, nor is the fact that the company made the benefit available solely due to health and safety concerns during COVID-19.While the analysis remains the same, the C&DI notes that the conclusion as to perk status may be different during COVID-19. The C&DI notes that "[w]hether an item is 'integrally and directly related to the performance of the executive's duties' depends on the particular facts. In some cases, an item considered a perquisite or personal benefit when provided in the past may not be considered as such when provided as a result of COVID-19." For example, before COVID-19, company reimbursement for a CEO's home office would have been considered a perk, but during COVID-19, in the face of mandatory remote work scenarios, a company could conclude that establishing a home office for the CEO is necessary for him or her to do his or her job. In that case, the benefit would not constitute a perk.

Public companies should review their expense and reimbursement practices and related disclosure controls to ensure they are properly identifying, tracking, and reporting all reportable perks, including any new perks that arose during COVID-19. Three SEC enforcement actions (See Argo Group International Holdings: https://www.sec.gov/news/press-release/2020-127; Hilton Worldwide Holdings: https://www.sec.gov/news/press-release/2020-242; and RCI Hospitality Holdings: https://www.sec.gov/enforce/34-89935-s) in the second half of 2020 regarding inadequate perks disclosure make it clear that the SEC is paying attention to these disclosures.

d. *Repricing Stock and Option Awards – Summary Compensation Table Disclosure.*If a public company repriced or materially modified a named executive officer's outstanding equity award during 2020, Instruction 2 to Regulation S-K, Item 402(c)(2)(v) and (vi) requires the company to report the incremental fair value of the repriced or modified award, computed as of the repricing or modification date in accordance with FASB ASC Topic 718, in the Option Awards or Stock Awards column of the Summary Compensation Table, in addition to reporting the fair value of any equity award originally granted to the named executive officer during 2020.

8. PLANNING FOR VIRTUAL AND HYBRID ANNUAL SHAREHOLDER MEETINGS.

Many public companies may have decided to move forward with a virtual or hybrid annual meeting in 2021 or may still be considering their options. In either event, public companies will benefit from early planning for the spring and early summer annual meeting season in the following areas:

`. If applicable state corporate law permits virtual or hybrid annual meetings, a company should be sure its governing documents are written broadly enough to encompass meetings held entirely or partially through remote means. If a company's state of incorporation permitted virtual or hybrid meetings only through temporary relief in 2020, the company should develop a process for monitoring the expiration or extension of that relief for 2021.

`. When preparing the annual meeting schedule, a company should consider including additional time to

accommodate necessary changes in direction, such as a change from an in-person meeting to a virtual or hybrid format, or a change to notice and access delivery of proxy materials instead of traditional full-set printing and mailing.

- A company should begin a conversation with potential annual meeting service providers soon, to ensure they can provide the services the company wants on the schedule it needs.
- A company should consider the views of its institutional investors and proxy advisory firms regarding virtual and hybrid annual meetings and engage in outreach as appropriate. In addition, a public company should ensure that the proxy statement includes robust disclosure in plain English about why the company has chosen to offer a virtual or hybrid meeting, and how shareholders can access the meeting, obtain technical support, ask questions, and submit their votes remotely.

When planning a virtual or hybrid annual shareholder meeting, public companies should consider the ISS and Glass Lewis guidelines for meetings to be held in 2021.

9. PROXY ADVISORY FIRM VOTING POLICY UPDATES.

a. ISS.In November 2020, ISS issued new benchmark policies (See https://www.issgovernance.com/file/policy/latest/americas/US-Voting-Guidelines.pdf) for U.S. public companies conducting shareholder meetings on or after February 1, 2021. ISS is an influential proxy services firm, and its proxy guidelines and voting recommendations are used by many institutional investors. Among the changes, ISS adopted a new voting policy with respect to boards lacking racial and ethnic diversity. The policy has a one-year transition period to 2022. In 2021, ISS research reports will highlight boards of companies in the Russell 3000 or S&P 1500 that lack racial and ethnic diversity (or related disclosure). The policy will not use a lack of racial and ethnic diversity as a factor in its vote recommendations on directors in 2021. For 2022, for companies in the Russell 3000 or S&P 1500 where the board has no apparent racially or ethnically diverse members, and no mitigating factors are identified, ISS's policy will provide for recommending voting against or withholding votes with respect to the chair of the nominating committee (or other directors on a case-by-case basis). Mitigating factors will include the presence of a racial and/or ethnic minority on the board at the preceding annual meeting, and a firm commitment to appoint at least one racially and/or ethnically diverse member.Additional changes to ISS benchmark policies include, among other things: potential vote recommendations against board members resulting from significant risk oversight failures related to environmental and social concerns, including climate change; the elimination of the transition period for board gender diversity; for companies in the Russell 3000 or S&P 1500, the potential triggering of voting recommendations against the chair of nominating committees where the board has no gender diversity; and potential recommendations against directors who unilaterally adopt a poison pill with a "deadhand" or "slowhand" feature. ISS will enhance its review of board refreshment practices, although its polices on board refreshment remain limited. ISS also has modified its criteria for determining the independence of directors, including adding a new criteria that directors who receive compensation similar to named executive officers are potentially not independent directors. In October 2020, ISS released guidance for COVID-19-related changes to compensation, recommending that companies provide clear disclosure of any such changes and the related rationale. Also, ISS discontinued its prior practice of providing draft reports to S&P 500 companies.
b. *Glass Lewis*.In November 2020, Glass Lewis released new policy guidelines for U.S. public companies conducting shareholder meetings during the 2021 season. Glass Lewis is an influential proxy services firm and is a competitor of ISS. Glass Lewis has expanded its policy guidelines for board gender diversity, and in its reports will note as a concern boards that include fewer than two female directors. Beginning with shareholder meetings held after January 1, 2022, Glass Lewis generally will recommend voting against the nominating committee chair of a board with more than six members but with fewer than two female directors.Beginning with the 2021 proxy season, Glass Lewis's reports for companies in the S&P 500 index will include an assessment of company disclosure in the proxy statement relating to board diversity, skills, and the director nomination process. Glass Lewis will not make voting recommendations solely on the basis of this assessment in 2021. Additional changes to Glass Lewis's policy guidelines include, among other things: potential reporting of concerns regarding board refreshment where the average tenure of non-executive directors is 10 years or more, and no new independent directors have joined the board in the past five years; and potential reporting of concerns when boards of companies in the S&P 500 index do not provide clear disclosure concerning the board-level oversight afforded to environmental and/or social issues. Glass Lewis noted that companies should

provide clear disclosure as to the rationale for any changes to incentive plans (*e.g.*, increasing payouts or lowering performance criteria), and while the ongoing COVID-19 pandemic was not explicitly mentioned, changes to compensation resulting from the pandemic may be scrutinized.

10. DIVERSITY CONSIDERATIONS.

Regulatory bodies, states, proxy advisory firms, institutional investors and the media intensified and expanded diversity initiatives in 2020 and heading into the 2021 reporting season.

In her September 2020 remarks at the Council of Institutional Investors Conference, SEC Commissioner Allison Herren Lee stated: "Recent events have triggered an unprecedented national conversation on racial injustice that also highlights the urgency of ensuring diverse perspectives and representation at all levels of decision-making in our country. At the SEC, a number of recent rulemakings have also pushed this issue to the forefront."(See here for Ms. Lee's remarks. Regulation S-K, Item 101(c)(2)(ii) now requires disclosure regarding the registrant's human capital resources, measures and objectives. See here for the adopting release.)

On December 1, 2020, The Nasdaq Stock Market LLC proposed a new listing rule (see Rule Proposal, FAQs – Board Diversity Matrix, FAQs – Voluntary Disclosure, and FAQs – Undisclosed Category) that would require all companies listed on Nasdaq's U.S. exchange to publicly disclose consistent, transparent diversity information regarding their board. The proposed rules also would require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors on the board. This proposed listing rule would have a phase-in period based on each company's listing tier. Our client alert provides additional information regarding this proposed listing rule.

Regarding state activity, California leads the charge with a new law enacted in 2020 for all public companies headquartered in California. The law requires at least one minority director on the public company's board of directors by the end of 2021. The law also contains additional requirements for larger boards of directors, for up to two or three mandatory minority directors based on the size of the board. This law comes on the heels of California's 2018 law, which set state minimums for female board representation. New York also enacted legislation in early 2020 to require organizations to report their board composition.

More than ever, investors are urging public companies to be transparent in their disclosure regarding diversity data. In addition, investors have started using their voting power to advance their diversity initiatives. For example, starting in 2020, State Street began voting against the entire slate of nominating and governance directors if the company does not have at least one female director, and has not engaged with State Street regarding board diversity for four years.

In early 2020, BlackRock stated that boards should be composed of diverse individuals who bring their personal and professional experiences to bear. For 2021, BlackRock accelerated the roll-out of its expectations, publishing its 2021 Stewardship Expectations and its 2021 Proxy Voting Guidelines in early December 2020. BlackRock indicated that the updates are the natural next step following the commitments it made last January 2020. Changes related to diversity address board quality, board and workforce ethnic and gender diversity, and other diversity, equity, and inclusion initiatives. In the United States, BlackRock is asking companies to disclose the diversity of their workforce, including demographics such as race, gender, and ethnicity, through the disclosure of EEO-1 data, as well as the actions they are taking to advance diversity, equity, and inclusion and support an

engaged workforce. Additional information about BlackRock's commitment to diversity and inclusion initiatives can be found here and here.

Investors have also taken to the court system to demand action regarding diversity. In July 2020, three separate shareholder derivative lawsuits were filed in the California federal court system against the directors and officers of Oracle, Facebook and Qualcomm for failing to deliver on board and executive diversity. Additional complaints have been filed against other public companies alleging breaches of fiduciary duties for making false assertions about diversity commitments.

This press appears to be leading to visible changes. Based on these and other diversity initiatives, as of August 2019 the S&P 500 no longer contained any all-male boards. Reports such as McKinsey's May 2020 report on diversity reinforce the need for these changes. This report found that companies in the top quartile for executive team gender diversity were 25 percent more likely than their peers to experience above-average profitability.

The other arena in which we are seeing these trends play out is in the proxy advisory space. As discussed in Item 9 above, ISS and Glass Lewis have both increased their expectations with respect to diversity and voting recommendations. ISS and Glass Lewis will implement the increased expectations described in their recent policy changes starting next year. ISS will recommend a vote "against" or "withhold" for the nominating and governance committee for all Russell 3000 and S&P 1500 index companies with no racially or ethnically diverse directors. ISS's 2020 global benchmark policy survey found that 73 percent of investors indicated that all boards should disclose board demographics (including race and ethnicity).

Glass Lewis's new policies will note as a "concern" boards with fewer than two female directors, and starting in 2022 will recommend voting "against" the nominating and governance committee chair for companies that have fewer than two female directors on their board. Glass Lewis will also make recommendations in accordance with state laws, for example the new California law discussed above, regarding board diversity.

As expected, we are continuing to see a greater push for public companies to be responsive to and involved with social movements, as well as a heightened awareness of the need to address inequalities and promote diversity initiatives on all fronts.

Public companies that delay implementing ESG programs or fail to meaningfully engage with their investors regarding diversity and social initiatives may receive shareholder proposals seeking disclosure of key metrics, such as median gender and racial pay equity, as well as diversity data. Institutional investors will continue to exert their influence through proxy voting.

11. D&O QUESTIONNAIRE UPDATES.

Public companies should consider the following potential changes to the Director and Officer Questionnaires (D&O Questionnaires) for the 2021 reporting season.

a. In February 2019, the SEC released two C&DIs on diversity disclosure requirements. In C&DI Questions 116.11 and 133.13 (which are identical), if a board or nominating committee considers "self-identified diversity characteristics" (such as, race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) of a person in determining whether to recommend him or her as a director – and if he or she has consented to disclosure – the SEC expects the company's proxy statement to identify those characteristics and

discuss how they were considered. To the extent that a company's nominating committee and/or board may consider any of these self-identified diversity characteristics in making its nomination decisions for its 2021 annual meeting, consider adding questions to the D&O questionnaires to gather this information and obtain the directors' consent to its disclosure. It is important to be respectful of the directors' privacy, so any such question should clearly indicate that providing the information or consent is optional. Companies may consider asking these questions of executive officers as well, in the event that they want to make similar diversity disclosures about the executive management team in the proxy statement.

b. In February 2020, the SEC approved Nasdaq's proposed change to the definition of "family member" to exclude stepchildren who do not share a director's home and domestic employees who reside in a director's home for purposes of determining director independence under Nasdaq Rule 5065(a)(2). Under the new Nasdaq rule, a "family member" is a person's "spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who share such person's home." For Nasdaq-listed companies, depending on which definition a company uses in its D&O questionnaire, the definition of "family member" may need to be updated to reflect this change. However, as was always the case, the board must still affirmatively determine whether the director has a relationship that could interfere with the director's exercise of independent judgment (including family relationships).

12. HEDGING DISCLOSURE REQUIREMENTS NOW APPLICABLE TO SMALLER REPORTING COMPANIES AND EMERGING GROWTH COMPANIES.

In December 2018, the SEC adopted rule amendments requiring public companies either to: (i) describe their policies related to the ability of employees and directors to hedge company securities; or (ii) state that they do not have any such policies, or that employees and directors are allowed to hedge company securities. Technically, these rules do not require public companies to adopt policies restricting employees and directors from hedging company securities. However, a public company that discloses it has no or limited hedging restrictions should expect increased shareholder scrutiny.

Most public companies were required to provide this disclosure in proxy statements during fiscal years beginning on and after July 1, 2019, which were filed for the 2020 proxy season for calendar year end and most other public companies. However, "smaller reporting companies" and "emerging growth companies" (each as defined in Securities Exchange Act Rule 12b-2) were not required to comply with this requirement until the proxy statements filed during fiscal years beginning on or after July 1, 2020. For most smaller reporting companies (SRCs) and emerging growth companies (EGCs), this disclosure will first be required in the proxy statement for the 2021 annual meeting of shareholders.

SRCs and EGCs that have not already adopted hedging policies should consider whether to do so, either independently or as part of insider trading policies, before filing their next proxy statements. Although SRCs and EGCs are not required to adopt hedging policies, most larger public companies have done so. As a practical matter, many larger public companies opted to prohibit hedging, immediately or through a phase out period, rather than risk any negative investor sentiment or publicity regarding insider hedging. Even if an SRC or EGC previously adopted a hedging policy, it should review its policy in light of current market practice.

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