



2019 PROXY SEASON UPDATE: KEY CONSIDERATIONS FOR PUBLIC COMPANIES

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Topics to Be Discussed

1. Dodd-Frank Rulemaking Update
2. Pay Ratio Developments and Year Two Considerations
3. Proxy Statement Trends
4. Form 10-K Developments
5. Governance Developments
6. ISS and Glass Lewis – Proxy Voting Updates
7. SEC Legal and Accounting Review Hot Buttons
8. Planning for Critical Audit Matters (CAMs) Disclosure

Dodd-Frank Rulemaking Update

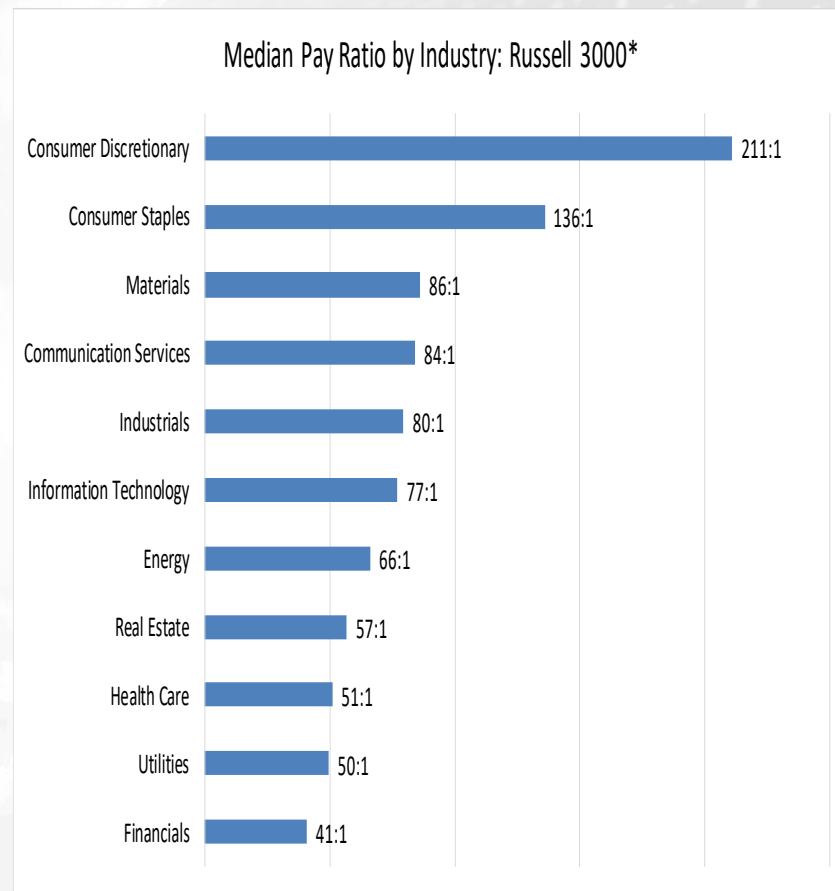
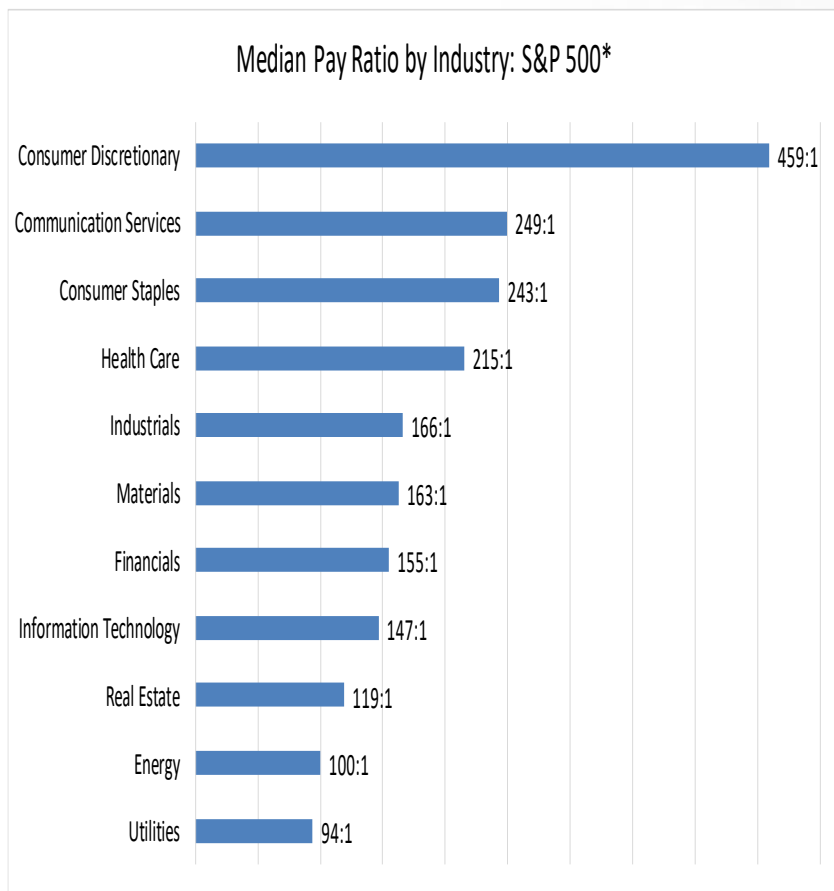
- Status of Three Dodd-Frank Rulemaking Proposals:
 - Hedging Policy Disclosure by Employees and Directors;
 - Pay Versus Performance Disclosure; and
 - Clawbacks of Compensation for Financial Restatements.

Pay Ratio Developments

- Pay ratios disclosed for the first time in 2018 proxy
- Pay ratios and levels of median employee compensation were highly correlative to industry
- Surprisingly, pay ratio disclosures drew little reaction from the press, the public, unions or Capitol Hill

Pay Ratio Developments (cont.)

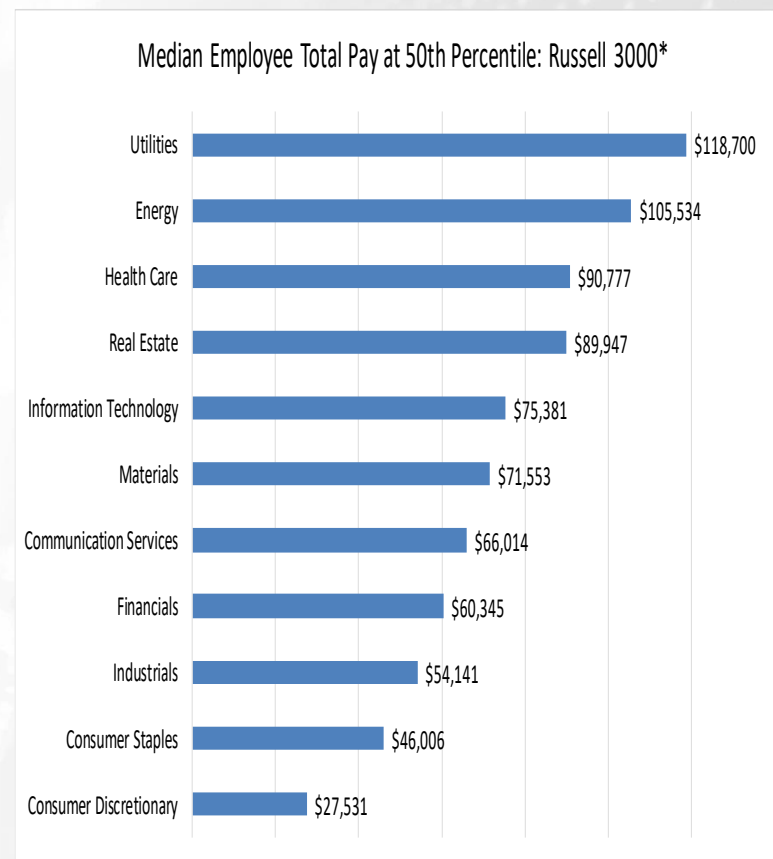
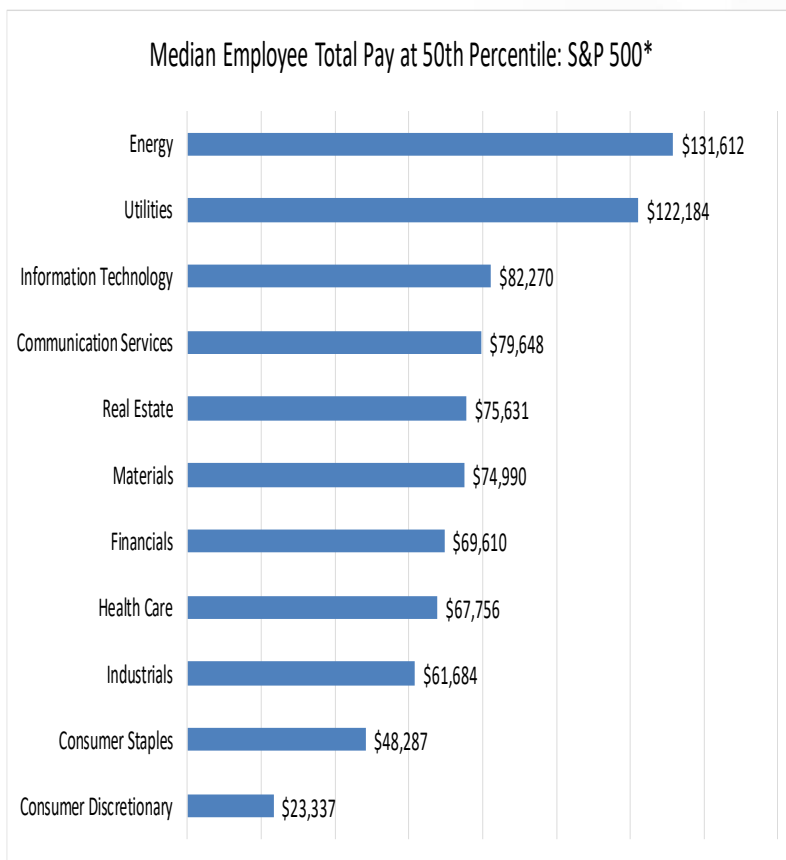
Comparison of S&P 500 and Russell 3000 Median Pay Ratio by Industry Sector



*Data derived from Main Data Group

Pay Ratio Developments (cont.)

Comparison of S&P 500 and Russell 3000 Median Employee Total Pay by Industry Sector at 50th Percentile



*Data derived from Main Data Group

Pay Ratio Disclosure – Year Two

- Review pay ratio disclosure of peer companies
- Consider whether to use the same “median employee”
 - Using the same median employee:
 - May use same median employee for three years unless:

“during a registrant's last completed fiscal year there has been no change in its employee population or employee compensation arrangements that it reasonably believes would result in a significant change to its pay ratio disclosure.”
 - If use same median employee, must disclose this fact and describe briefly the basis for its reasonable belief

Pay Ratio Disclosure – Year Two (cont.)

- If required to use a different median employee
 - “may use another employee whose compensation is substantially similar to the original median employee based on the compensation measure used to select the original median employee.”

Pay Ratio Disclosure – Year Two (cont.)

- Other pay ratio changes to consider:
 - Determination date used to select the median employee;
 - Exclude non-U.S. employees under the 5 percent exclusion allowance;
 - Exclude employees from current year acquisitions;
 - Make cost-of-living adjustments to the compensation of employees who reside outside the jurisdiction of where the CEO resides; and
 - Present additional information, including additional ratios, to supplement the required ratio.

Pay Ratio – Year Two (cont.)

- Communications to Compensation Committee
 - Explanation of material difference in year-over-year pay ratio and median employee compensation (may be desirable to include such explanation as a volitional disclosure)
 - Comparison of company pay ratio to peers (and explanation if pay ratio is an outlier)
- Effect of Pay Ratio on 2019 Say on Pay Vote Outcomes
 - Pay ratio will not likely influence 2019 say on pay vote outcomes
 - Neither ISS nor Glass Lewis have adopted proxy voting policies covering the pay ratio
 - Additionally, large institutional shareholders have not focused on the pay ratio
 - Exception may be for companies whose pay ratios are outliers among peer companies

Proxy Statement Perquisite Disclosure

- SEC enforcement actions brought during 2018 related to inadequate disclosure of perquisites
- SEC Settlement with large public company in 2018
 - Failure to disclose approximately \$3 million in CEO perquisites
 - SEC alleged that, in evaluating perquisites, the company applied test that did not conform to SEC's standards for perquisite disclosure:
 - Item *is not a perquisite* if it is integrally and directly related to the performance of the executive's duties.
 - Item *is a perquisite* if it confers a direct or indirect benefit that has a personal aspect without regard to whether it may be provided for some business reason or for the company's convenience, unless it is generally available on a non-discriminatory basis to all employees.

Proxy Statement Trends

- Changes in proxy statements have been driven, in part, by proxy advisors' and institutional shareholders' expectations and changes in corporate governance, particularly with respect to disclosures in CD&As
- Changes have focused on basic and volitional disclosures
 - Areas of concern regarding basic disclosures, include
 - Clarity of disclosure
 - Rationale for performance metrics
 - Rigor of performance goals
 - Determination of payouts
 - Rationale for special grants and discretionary awards
 - Purpose of volitional disclosures
 - To enhance clarity of disclosures
 - To provide an increased understanding of pay decisions and outcomes

Proxy Statement Trends (cont.)

■ Key Volitional Disclosures

Type of Volitional Disclosure	Prevalence*
Executive summary of the CD&A	97%
Absolute company performance	86%
Realized/realizable pay – CEO only	81%
Board diversity	79%
Relative company performance	47%
Shareholder outreach disclosures, including feedback and/or actions taken	46%
Pay for performance (e.g., comparing multi-year CEO pay and company TSR)	29%

*Data derived from Meridian Compensation Partners 2018 Corporate Governance & Incentive Design Survey, which covers 200 large public companies

■ Other Types of Volitional Disclosures

- Enhancements to director pay disclosures
- Improvements to design and look of proxy statement
- Env., social and governance (ESG) and corporate social resp. (CSR) initiatives

Form 10-K Developments

- “Smaller Reporting Company” definition amended, effective September 2018
 - Increases public float threshold from \$75 million to \$250 million
 - Increases annual revenues threshold from \$50 million to \$100 million for companies with no public float
 - Annual revenues threshold will now apply to companies with less than \$700 million public float (rather than only to companies with no public float, as provided prior to amendments)
 - A company that does not qualify as a SRC under the initial qualification thresholds will remain unqualified until it meets one of the lower qualification thresholds (set at 80% of the amended initial public float and revenue thresholds)

Form 10-K Developments (cont.)

Amendments to definition of “Smaller Reporting Company”

- “Accelerated Filer” and “Large Accelerated Filer” definitions amended so that qualifying as an SRC no longer automatically results in the company being a non-accelerated filer
 - A Smaller Reporting Company with a public float of \$75 million or greater will continue to be subject to accelerated filer requirements

Form 10-K Developments (cont.)

- “Disclosure Simplification” rule amendments
 - Segment financial information in Business section
 - Research and development expenses
 - Financial information by geographic area in Business section
 - High and low sales price for common stock
 - Ratio of earnings to fixed charges

Form 10-K Developments (cont.)

- Director and Officer Questionnaires:
 - No new SEC, NYSE or NASDAQ requirements
 - Questions relating to Section 162(m) and “outside director” eligibility
 - Solicitation of perquisite information
 - Any relevant regulatory or industry-specific developments
 - Consider whether to solicit additional information if company is considering including disclosure to address “hot topics” being raised by institutional shareholders and proxy advisory firms

Form 10-K Developments (cont.)

- Cybersecurity – New SEC Guidance with focus on:
 - Disclosure Controls and Procedures; and
 - Insider Trading Policies.
- Other areas of recent SEC focus:
 - Brexit Impact
 - LIBOR Phase-out

Governance Developments

- Board Gender Diversity
- Limits on Non-employee Director Compensation
- Clawback Policies
- Forfeiture Policies
- Regulation of Proxy Advisory Firms

Governance Developments (cont.)

Board Gender Diversity – Current State

- At Large Public Companies

	S&P 500	Russell 3000
% of boards with at least one woman director	99% ¹	85% ¹
% of newly elected board members who are women	38% ²	21% ³
Total board seats held by women	22% ²	16% ³

- At Newly Public Companies (75 Largest IPOs 2014 – 2016)

Number of Women on the Board	% of IPO Companies ⁴
No women board members	49%
One woman board member	25%
Two or more women board members	26%

¹ Institutional Shareholder Services, *U.S. Board Study: Board Diversity Review*, April 11, 2018

² Heidricks & Struggles, *Press Release*, January 1, 2018

³ Equilar Blog, *Boards Will Reach Gender Parity in 2055 at Current Pace*, January 31, 2017

⁴ 2020 Woman on Boards, *Women: Not Present on IPO Company Boards*

Governance Developments (cont.)

Board Gender Diversity

- External parties are among the key forces driving board gender diversity
 - State of California recently enacted legislation that imposes gender quotas on public companies headquartered there
 - ISS and Glass Lewis have adopted voting policies on board gender diversity
 - Large institutional investors have become outspoken on the issue of gender diversity
 - State Street will vote against all members of a company's nominating committee if the company's board does not include any women directors (starting 2020)
 - BlackRock's 2018 proxy voting guidelines provide that the fund "would normally expect to see at least two women directors on every board"
 - Vanguard, in an open letter to public company directors, noted that board diversity is "an economic imperative, not an ideological choice"

Governance Developments (cont.)

Limits on Director Compensation

- Increased prevalence of annual limits on director compensation due to a series of Delaware cases
- Typically, annual limits apply to equity compensation, but increasingly apply to both equity and cash compensation
 - Typically, limits are set as a multiple of annual director pay (“meaningful limits” per *Seinfeld* case)
 - Unclear if companies will embrace the prescriptive limits suggested by the *Investors Bancorp* case
- Generally, pay limits are added to an equity plan in the year plan is subject to shareholder approval
- Also in response to the Delaware cases, companies have begun to enhance their proxy disclosures on director compensation (e.g., director pay philosophy, the process for setting director pay, use of peer group)

Governance Developments (cont.)

Clawback Provisions

- Clawback provisions are getting a second look
- Key areas of focus include:
 - Moving from fault to no-fault policy (i.e., a policy to prevent “unjust enrichment” rather to punish misconduct)
 - Clarifying or expanding the range of potential recoupment methods, such as offset of current compensation and forfeiture of outstanding awards
 - Adding administrative provisions outlining the duties and powers of the Compensation Committee and/or Board in overseeing the clawback policy

Governance Developments (cont.)

Forfeiture Provisions

- Due to corporate scandals and executive misconduct, many companies are reviewing or implementing forfeiture provisions
- Key areas of focus include:
 - Covered employees
 - Triggering event (e.g., breach of restrictive covenants, misconduct)
 - Types of compensation subject to potential forfeiture or recoupment
 - Lookback and lookforward periods

Governance Developments (cont.)

Regulation of Proxy Advisory Firms

- Recent events suggests that “meaningful” regulation of proxy advisory firms (PAFs) may be near
 - A bipartisan group of Senators introduced the Corporate Governance Fairness Act which would subject PAFs to the Investment Advisers Act (“Advisers Act”)
 - The SEC staff held roundtable discussions that covered the role of PAFs in the proxy process
 - BlackRock submitted a letter to the SEC supporting regulation of the PAFs
 - The Senate Banking Committee held hearings examining the role of PAFs
 - SEC Chair Jay Clayton suggests rulemaking may be required to resolve issues raised by PAFs’ operations and directs the SEC staff to develop recommendations for the Commission’s consideration

Governance Developments (cont.)

- Despite these events, enactment of meaningful regulation of PAFs is far from certain
 - The Fairness Act, if enacted, would not impose meaningful regulation on PAFs
 - ISS's status as a registered investment adviser has had no apparent effect on its business model or operations
 - Neither the Senate Banking Committee hearing nor the SEC staff roundtable developed a consensus to impose regulations on PAFs beyond the Fairness Act
 - Importantly, institutional investors at the roundtable (and generally) do not support significant regulation of the PAFs (other than BlackRock)
 - The wild card is SEC Chair Clayton's direction to the Staff to make recommendations to the Commission on potential rulemaking

ISS/Glass Lewis – Proxy Voting Updates

- Institutional Shareholder Services (ISS) proxy voting policy updates for 2019
 - ISS updates take effect for annual meetings on or after February 1, 2019
 - Notably, ISS has issued no new updates on executive compensation
 - ISS has also published a preliminary FAQ on compensation policies with a final version to be issued in December
- Glass Lewis (GL) proxy voting policy updates for 2019
 - GL updates take effect for annual meetings on or after January 1, 2019
 - GL is clarifying its policies on executive compensation, but is not making significant changes to its underlying assessment methodology

ISS/GL – Key Proxy Voting Updates (cont.)

ISS – Key Proxy Voting Updates

Policy Area	When the Following Conditions Exist:	ISS Will Recommend a Vote Against:
Board Composition – Diversity <ul style="list-style-type: none"> • Applicable to Russell 3000/S&P 500 companies • <i>Effective for 2020 meetings</i> 	<ul style="list-style-type: none"> • No women on company board 	<ul style="list-style-type: none"> • Chair of nominating committee subject to mitigating factors
Equity Plan Proposals	<ul style="list-style-type: none"> • Share dilution exceeds: <ul style="list-style-type: none"> ➢ 20% for S&P 500 companies ➢ 25% for Russell 3000 companies 	<ul style="list-style-type: none"> • Management's equity plan proposal
Non-employee Director Compensation <ul style="list-style-type: none"> • Effective for 2020 meetings 	<ul style="list-style-type: none"> • “Excessive” level of non-employee director compensation (ISS to develop method for determining excessive pay) 	<ul style="list-style-type: none"> • Committee Chair and members who are responsible for setting director pay
Management Proposals to Ratify Existing Charter or Bylaw Provisions <ul style="list-style-type: none"> • <i>Policy seeks to discourage management proposals used to block shareholder proposals that seek more favorable shareholder rights</i> 	<ul style="list-style-type: none"> • Charter/bylaw provisions subject to management proposal do not align with best practice 	<ul style="list-style-type: none"> • Management proposal and Individual directors, members of the governance committee or the full board, taking into account up to nine factors

ISS/GL – Key Proxy Voting Updates (cont.)

GL – Key Proxy Voting Updates (cont'd)

Policy Area	When the Following Condition(s) Exist:	GL Will Recommend a Vote Against:
Board Composition – Diversity	<ul style="list-style-type: none"> No women on company board 	<ul style="list-style-type: none"> Chair of nominating committee
Conflicting Special Meeting Proposals Conflicting	<ul style="list-style-type: none"> The proxy includes a management and shareholder proposal requesting different thresholds for the right to call a special meeting 	<ul style="list-style-type: none"> The proposal calling for the higher threshold <i>(Note: Glass Lewis will recommend a vote FOR the proposal calling for the lower threshold)</i>
	<ul style="list-style-type: none"> Company has excluded a special meeting shareholder proposal in favor of a management proposal ratifying an existing special meeting right 	<ul style="list-style-type: none"> Management's ratification proposal and Members of the governance committee
Excluded Shareholder Proposals	<ul style="list-style-type: none"> The exclusion of a shareholder proposal was detrimental to shareholders 	<ul style="list-style-type: none"> Members of the governance committee in "very limited circumstances"
Environmental and Social (ES) Risk Oversight	<ul style="list-style-type: none"> Company has not properly managed/mitigated ES risks to the detriment of shareholder value 	<ul style="list-style-type: none"> Directors who are responsible for oversight of ES risks In the absence of such oversight, members of the audit committee

ISS/GL – Key Proxy Voting Updates (cont.)

GL – Key Proxy Voting Updates (cont'd)

Policy Area	The Following Condition(s) Exist:	Effect on GL Vote Recommendation
Clawback policies	<ul style="list-style-type: none"> • A robust (more expansive) clawback policy • A clawback policy that satisfies minimum legal requirements 	<ul style="list-style-type: none"> • May positively influence GL's view of a company's compensation program • May negatively influence GL's view of a company's compensation program
Discretionary Bonus Plans	<ul style="list-style-type: none"> • Maintenance of discretionary bonus plan 	<ul style="list-style-type: none"> • Standing alone will not result in a negative SOP vote recommendation
Incentive Plans	<ul style="list-style-type: none"> • No caps on payouts • Lack of performance-based LTI 	<ul style="list-style-type: none"> • May result in a negative SOP vote recommendation
Excise tax gross-ups	<ul style="list-style-type: none"> • Adoption of new agreements with excise tax gross-ups 	<ul style="list-style-type: none"> • May result in a negative vote recommendation on compensation committee members
Severance/Sign-on Arrangements	<ul style="list-style-type: none"> • Outsized severance/sign-on benefits • Terms include board continuity conditions, excessively broad CIC triggers, "poor wording" of employment agreements and multi-year bonus guarantees 	<ul style="list-style-type: none"> • May result in a negative SOP vote recommendation

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SECURITIES AND EXCHANGE COMMISSION (SEC)

SEC accounting comments

Comment area	Ranking 12 months ended 30 June		As percentage of total registrants that received comment letters
	2018	2017	2017 and 2018
Management's discussion and analysis	1	2	43%
Non-GAAP financial measures	2	1	47%
Fair value measurements	3	3	17%
Segment reporting	4	4	15%
Revenue recognition	5	5	13%
Intangible assets and goodwill	6	6	11%
State sponsors of terrorism	7	7	12%
Income taxes	8	8	12%
Acquisitions and business combinations	9	9	8%
Contingencies	10	-	8%

SEC accounting comments (cont.)

- Management's discussion and analysis (MD&A) is back in the top spot as the most frequent area of comment, moving slightly ahead of non-GAAP financial measures.
- The SEC staff also continues to question registrants' disclosures related to significant judgments and estimates, including those related to segment reporting, goodwill impairment and income taxes.
- Comments issued to early adopters of the new revenue recognition standard have also focused on areas of judgment (e.g., identifying performance obligations, determining the timing of satisfaction of performance obligations, determining the amortization period of capitalized contract costs) and may indicate areas the SEC staff will focus on when reviewing the filings of registrants that adopted the standard in 2018.

SEC accounting comments (cont.)

- Regarding proxies, the SEC staff recently has commented on:
 - Effects of performance criteria and targets, and shareholder advisory votes on compensation decisions
 - Basis for identifying fewer than five named executive officers
 - Requirements to update executive compensation disclosures in registration statements

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

AS 3101: Reports on Audited Financial Statements

- PCAOB adopted a final auditing standard (PCAOB Release No. 2017-001) aimed at making the auditor's report more relevant and information for investors and other financial statement users
- Effective for audits of financial statements for annual periods ending on or after 15 December 2017, except for requirements related to critical audit matters which have a later effective date (30 June 2019 for accelerated filers and 15 December 2020 for all other companies)

AS 3101: Reports on Audited Financial Statements (cont.)

- In the second phase of changes required under the revised PCAOB standard on the auditor's report (in annual reports for fiscal years ending on or after June 30, 2019 for large accelerated filers), auditors will be required to disclose information about matters that were communicated or required to be communicated to the audit committee that are material to the financial statements and involved especially challenging, subjective or complex auditor judgment
- For each critical audit matter (CAM), auditors are required to:
 - Identify the matter
 - Describe the principal considerations in determining that the matter was a CAM
 - Describe how the matter was addressed in the audit
 - Refer to the relevant financial statement accounts or disclosures

AS 3101: Reports on Audited Financial Statements (cont.)

- Other standard setting bodies have already made similar changes to the auditor's report:
 - International Standards on Auditing (ISA) requires discussion of key audit matters (KAMs) for periods ending on or after 15 December 2016
 - European Union will require an expanded auditor's report for periods ending on or after 30 June 2017

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Meridian Compensation Partners, LLC is one of the largest independent executive compensation and corporate governance consulting firms in North America. Meridian currently serves over 600 large publicly and privately held clients, including 15% of the S&P 500®.

Meridian consultants advise Boards of Directors and senior management on the full range of executive compensation issues that confront them. Whether the subject is compensation philosophy, pay-for-performance, incentive plan designs, shareholder initiatives, change-in-control severance protections, mergers and acquisitions or Board governance, we have the resources, experience and expertise to help. We guide Compensation Committees as they make often difficult, but informed, decisions on executive pay. Our decades of experience provide context for our clients to make sound business judgments.

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