2023 Proxy Season - What to Think About

The new pay versus performance rule is foremost in the minds of public companies as they prepare for their upcoming proxy statement. But don't lose sight of other areas where investors and regulators will be paying particular attention this proxy season. Below we discuss topics where we've seen considerable focus.

Board Composition and Refreshment

Board diversity continues to be a focus area for investors and regulators. The topic is not just omnipresent in investor engagement discussions, but also embodied in proxy advisor voting guidelines, institutional investor voting policies, and stock exchange regulations. While California courts have overturned as unconstitutional that state's laws requiring boards of public companies to include mandated numbers of women and members of underrepresented communities (the state of California is appealing), the push for Board diversity is not abating.

The way diversity is disclosed is also under scrutiny. The SEC's regulatory agenda includes a rule to enhance disclosure about board diversity. While the more common approach among Fortune 100 companies is to provide only Board-level diversity statistics, there is significant and growing number that identify diversity characteristics by director.

To consider:

- Do you clearly explain the Board's approach to diverse composition? Is it clear what diversity means?
- Is it clear to stakeholders what diversity characteristics each director possesses? Would a photograph help communicate diversity?
- Do you explain why the composition of the Board, including — or especially — the nominees, contains the appropriate level of diversity, and if not how the Board plans on getting to the ideal composition?

Board competency. Investors are focusing on more than just diversity when they look at Board composition. In assessing Board nominees, investors are evaluating Board competency, informed decision-making and robust oversight. Director skills and expertise are a critical component of this evaluation, and investors are seeking more clarity about what makes a director an expert. The SEC's proposed rules on cybersecurity and climate change highlight this push: each rule proposes disclosure about whether any directors have expertise in the rule's subject matter, including supporting detail as necessary to fully describe the nature of the expertise. We expect that the new universal proxy card will result in enhanced description of nominee qualifications even in uncontested elections.

To consider:

- Do you sufficiently explain how the Board as a whole has the necessary skills and expertise to oversee the company's key risks and opportunities?
- What experts should be identified? Should expertise be tied to the most significant risks and opportunities?
- Do the directors' skills and expertise continue to reflect the evolving direction/strategy of the company? How does the Board evaluate and refresh its skills?

Risk Oversight

Investor and regulator focus on risk oversight remains strong. They want to know not just what risks the Board is overseeing, but how they are exercising their oversight function.

Oversight Topics. Consider what topics should be discussed together with risk or through the risk lens. The recent Boeing litigation highlighted the fundamental importance of active board oversight of "mission-critical" risks, and your enterprise risk management program can guide you in determining which risk topics should be on the Board's agenda. Recent SEC comment letters indicate that the SEC is looking for consistency between risk factor disclosure and Board oversight disclosures.

To consider:

- What significant risks does the Board devote significant time discussing? Are these the same as the "mission-critical" and other key risks identified by your ERM program?
- Does the risk oversight disclosure adequately reflect the material risks disclosed in your financial report filings?

Process disclosures. We are seeing more questions about the ERM process and how risks are identified, assessed and labelled material or otherwise rise to the level of Board oversight, as well as how and when the Board receives information about those risks. The SEC is also asking those questions: the proposed rules on climate change and cybersecurity propose disclosure about how Board oversight is structured, the process by which the board is informed, the frequency of discussion, and integration of risks into the strategy/risk/financial oversight processes. Recent SEC comment letters also request more information about how the Board exercises oversight over particular risks.

To consider:

- Do you describe how the Board exercises its oversight responsibilities? Can stakeholders determine information flow and what the process entails?
- Is your disclosure about the company's risk identification and management program transparent? Does it explain how management interacts with the Board on significant risk topics?

ESG

Inter-report disclosure consistency. Companies should consider consistency of ESG disclosures between their proxy statement and their ESG reports, guided by the SEC's comment letters on the topic. The SEC has questioned both more expansive disclosures in ESG reports than in filed reports, as well as disclosure about significant ESG initiatives in proxy statements that aren't reflected in capex or cost disclosures in financial reports.

To consider:

- How does the company determine which ESG disclosures appear in what report?

Oversight structure. We're seeing evolving models of Board oversight of ESG, including an integrated approach involving several committees overseeing different ESG aspects. Additionally, the structures, processes and disclosures for risk management and oversight of climate change as required by a final climate change (and cybersecurity) rule may become the best practice for other risk topics, such as ESG. Consider how the rules' requirements can inform your risk management/oversight program more broadly.

To consider:

- How is Board ESG oversight structured? Is this structure, and the rationale for it, clearly explained?

Clear link to strategy. More than 50 "anti-ESG" shareholder proposals were submitted last year, with most of them going to vote. These proposals included demands for disclosure about cost/benefit analyses, charitable contributions and lobbying payments, and policies and training. In light of this "anti-ESG" movement, Boards may want to consider a more robust explanation of how their ESG program ties directly to strategy. Such disclosure would also be in line with the proposed climate change and cybersecurity rules that would require more disclosure linking to strategy.

To consider:

- Does your disclosure clearly show the link between the company's ESG program/efforts and overall strategy?
- Are your public political contributions and lobbying efforts, as well as your internal training and strategic planning efforts, consistent with your environmental and social programs and policies? Should that information be public?

Additional social disclosures and location. Investors have been asking for additional data, and regulators are interested as well. Consider what additional data is appropriate and where disclosure should appear. Examples of possible disclosures include:

a. Workforce demographics and intersectionality. Investors are asking for more "intersectional" data — showing diversity by employee classification, whether by disclosing EEO-1 data on the company's website or including intersectional data in public reports.

b. Equity. Interest in pay and racial equity studies has grown, as well as in programs to identify and mitigate bias.

c. Workforce well-being. Employee well-being proposals (such as harassment and safety) were the most common HCM shareholder proposals in 2022. The SEC's regulatory agenda includes a proposal for additional HCM disclosures, which Chairman Gensler has indicated might include training, turnover, and health & safety.

d. Social capital management. This topic, which covers impact on stakeholders other than employees and shareholders (such as racial justice and human rights), constituted one of the largest categories of shareholder proposals last year, up considerably from the prior year. While only about 10% passed, the interest in this topic has grown.

e. Hot Topics. Given the variety of social shareholder proposal topics last year, we would not be surprised to see more proposals related to abortion access and reproductive rights (anti-ESG entities have already indicated they would submit), as well as on the broader impact of company/products/externalities on the community (2022 saw an increase in proposals regarding system stewardship).

To consider:

- Are there social topics/statistics that the CEO would like to highlight in his/her proxy letter, or as a "spotlight" of Board oversight? Are cross-references to other company publications containing social information appropriate?

Executive Compensation

Pay versus Performance. The new rule will add considerable volume to the proxy statement. Consider the most effective — readable and understandable — presentation of required disclosures, such as narrative versus graphics, tabular presentations, highlights and callouts. Consider also the iXBRL requirement.

Incentive Programs. Clear and transparent disclosure about incentive programs is a perennial demand.

To consider:

- Clarity. Are all your incentive goals described? Are the descriptions and mechanics easy to understand? Can a graphic help illustrate the goal?
- Goal rigor. An article in the Harvard Law School Forum on Corporate Governance indicates ISS is scrutinizing goal rigor where goals were lowered following challenging business conditions. Do you show continuing rigor?
- Individual performance/other discretionary elements. These elements continue to draw scrutiny. Are the parameters for awarding compensation based on individual performance, as well as the exercise of discretion, clearly set out?
- ESG performance metrics. While an ESG metric in incentive compensation evidences the importance of ESG to the company, investors are not keen on any metric that doesn't advance the company's strategy. As with all goals, does your disclosure clearly communicate how your ESG incentive goals are tied to strategy? Are the metrics and achievements clearly explained?

Company-Specific Issues. As always, it is imperative to clearly explain the rationale behind one-time awards, seemingly unchallenging goals, multi-year guaranteed payments, and unusual pay structures.

Board engagement and responsiveness. While pay/performance alignment is ISS's most prevalent compensation concern, board communications with and responsiveness to shareholders is one of ISS's five key SOP evaluation standards and is the second most common factor where ISS has high concern in companies with a negative recommendation — and in some companies it was the ONLY area of high concern.

To consider:

- Does your disclosure sufficiently describe the breadth of engagement with and feedback from investors, and how the Board responded to that feedback?

Other Topic-Specific Considerations

Climate change	• The proposed climate change rule is complex and entails much more granular disclosure than has been typical. Among other things, companies should be preparing for detailed disclosures about their processes for climate change governance, both at the management and Board levels. • Consider how to describe the Board's oversight of climate-related financial disclosures and ESG reporting; discussion about this seems to center around the audit committee.
Cybersecurity	• Companies should be laying the groundwork for compliance with the requirements of the proposed cybersecurity rule, including, if appropriate, formalizing cybersecurity risk management processes and the cybersecurity governance/oversight structure and process, at both the management and Board levels.
Ukraine	• Per the Division of Corporate Finance's sample comment letter, companies should consider disclosure of the role of the Board in overseeing material risk relating to Ukraine. State Street's guidance on geopolitical risk also highlights the importance of ensuring that companies adequately communicate the Board's involvement in overseeing significant risk topics.
Reputational Risk	• In several comment letters concerning particular risk topics, the SEC also asked companies about related reputational risk. Consider whether Board oversight of reputational risk is adequately disclosed.
Political Spending and Lobbying	• Stakeholder shave been focusing on the alignment between company values and priorities, on the one hand, and political spending and lobbying on the other. About 20 such "values congruency" shareholder proposals were submitted last year, with average support of the 10 going to vote about 40%. Consider whether proactive disclosure of your company's values congruency is appropriate.

www.argyleteam.com

Argyle Company
100 Burma Rd.
Jersey City, NJ 07305
(201) 793 5400

About Argyle

We are a creative communications firm offering end-to-end, in-house execution capabilities.

Our experienced and passionate team is composed of attorneys, designers, project managers, thinkers and web developers. We collaborate together around a process that encompasses drafting, editing, designing and publishing across all digital and print channels.

We are thrilled that communications prepared by Argyle have contributed to trustful relationships between our clients and their readers, whether investors, employees or other stakeholders.

In turn, our commitment to our clients has resulted in meaningful long-term relationships with some of the most respected public and private companies in the world.