PROXY SEASON AND FORM 10-K FILINGS:
A look back at 2015 and what to expect in 2016

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OVERVIEW

This overview summarizes new disclosure requirements and other developments that will generally be applicable to SEC reporting companies in connection with their upcoming proxy statement and Form 10-K filings, including those with respect to the executive compensation and corporate governance provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Dodd-Frank Rulemaking

During 2015, the SEC responded to mandates under the Dodd-Frank Act involving compensation-related matters. Specifically, the SEC adopted a final pay ratio disclosure rule and proposed a clawback listing standards rule, a pay versus performance disclosure rule and a hedging disclosure rule. The pay ratio disclosure rule has a relatively long transition period (to be applicable in the 2018 proxy season for calendar year companies), and the other three rulemaking projects currently remain in the proposal stage. As a result, at this point, none of these initiatives is likely to require additional disclosures in proxy statements during the 2016 season, although it is possible that the SEC could finalize the pay versus performance and/or hedging disclosure rules in time to implement them for the upcoming season.

- ***CEO Pay Ratio Disclosure.*** On August 5, 2015, the SEC adopted its long-awaited pay ratio rule that will require public companies to disclose annually (i) the median of the annual total compensation of all employees (excluding the CEO); (ii) the annual total compensation of the CEO; and (iii) the ratio of these two amounts. The final rule will also require disclosure of the methodology and any material assumptions, adjustments or estimates used to identify the median employee or to determine annual total compensation (or any elements of total compensation).[1]

- ***Employee/Director Hedging Disclosure.*** On February 9, 2015, the SEC proposed a rule that would require public companies to disclose in their proxy statements whether they permit any employees, officers or directors, or any of their designees, to purchase financial instruments or otherwise engage in transactions that are designed to have the effect of hedging or offsetting any decrease in the market value of company equity securities (i) granted as part of compensation; or (ii) held by them, directly or indirectly. Although this rule has not yet been adopted, a significant percentage of public companies have adopted anti-hedging (and in many cases, anti-pledging) policies (as part of their insider trading policy or otherwise) and have disclosed these policies in their proxy statements in light of the fact that such policies are viewed favorably by ISS and Glass Lewis.

- ***Pay-for-Performance.*** On April 29, 2015, the SEC proposed rules that would require public companies to include a new pay versus performance table in proxy statements. The table will show the amount of compensation paid to a company's CEO and its other named executive officers, cumulative total shareholder return ("TSR") and TSR of a peer group during each of the five most recent fiscal years (provided, that the disclosure requirement will initially be for three years, increasing by one additional year in subsequent years until such time that five years have been prepared). The proposed rules would also require companies to use the values presented in the table to describe the relationship between executive compensation and the company's performance, and between the company's performance and its peer group's performance.

[1] For additional information about this final rule, see our client alert dated August 10, 2015, entitled "SEC Adopts Final CEO Pay Ratio Rule".

- *Clawback Policies.* On July 1, 2015, the SEC proposed rules to require listed companies to adopt and enforce clawback policies applicable to incentive-based compensation received by current and former executive officers during the three-year period preceding the date the company is required to prepare an accounting restatement due to material noncompliance with financial reporting requirements. The proposed rules define "incentive-based compensation" as any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure. The proposed rules would require companies to pursue recovery of compensation under the terms of their policy unless it would be impracticable because it would impose undue costs on the company or would violate home country law based on an opinion of counsel. Significantly, the proposed rules would not require any fault on the part of the executive officer. A company would also be required to file its clawback policy as an exhibit to its Form 10-K and make certain disclosures in its proxy statement regarding any application of the clawback policy during the prior fiscal year. Once the SEC publishes final clawback rules (the "SEC Publication Date"), each exchange will have 90 days to file proposed listing standards that must thereafter become effective within one year of the SEC Publication Date. Companies would be required to adopt a compliant clawback policy no later than 60 days following the effective date of the applicable listing standards and to recover excess incentive-based compensation received on or after the SEC Publication Date if that compensation was based on financial information *for any period ending on or after the SEC Publication Date*.

2016 ISS and Glass Lewis Updates

ISS and Glass Lewis recently released their 2016 proxy voting guideline updates. The changes made to the 2015 voting guidelines of ISS and Glass Lewis were fairly limited in scope. The most significant changes to each of the guidelines are highlighted below.

ISS Updates

- *Overboarding.* ISS has lowered the acceptable number of public company board positions for directors who are not the CEO from six to five. There will be a one-year grace period until 2017, during which time ISS will include cautionary language in research reports. While ISS had considered changing the policy threshold at which a CEO will be considered "overboarded," it ultimately determined not to make a change to its existing policy of no more than two public company boards in addition to their own.

- *Unilateral Bylaw/Charter Amendments.* ISS will generally recommend a vote against directors (except new nominees, who should be considered case-by-case) if the board amends the company's bylaws or charter without shareholder approval to newly classify the board, establish supermajority vote requirements or eliminate shareholders' ability to amend bylaws. Such recommendations will continue until the unilateral action is reversed or ratified by a shareholder vote. ISS also has adopted a separate framework for assessing directors of newly-public companies that implement bylaw or charter provisions adverse to shareholders' rights prior to or in connection with the IPO.

Glass Lewis Updates

- *Overboarding.* Glass Lewis has lowered the number of board positions it views as acceptable: (i) for executive officers with outside directorships, a limit of one outside public company directorship aside from their own; and (ii) for directors who are not executive officers, reducing the acceptable number of total public boards from the current six to five. There will be a one-year grace period until 2017, during which time Glass Lewis will include cautionary language in research reports but will not recommend withholding votes for this reason.

- *Exclusive Forum Provisions (for IPO companies only).* For IPO companies that include exclusive forum provisions in their governing documents, instead of recommending against the chairman of the nominating and governance committee, Glass Lewis will evaluate the provisions alongside other governance provisions, such as supermajority vote requirements and a classified board structure. For non-IPO companies, Glass Lewis will continue to recommend voting against the chairman of the nominating and governance committee if exclusive forum provisions are adopted without a shareholder vote.

- *Nominating Committee Performance.* Beginning in 2016, Glass Lewis may consider recommending against the chairman of the nominating committee where a failure to ensure that the board has directors with relevant experience, either through periodic director assessment or board refreshment, has contributed to a company's poor performance. Glass Lewis has not specified how it will define "poor performance" or how it will assess what contributed to such performance.

- *Environmental and Social Risk Oversight.* In cases where the board or management has failed to sufficiently identify and manage a material environmental or social risk that Glass Lewis believes did or could impact shareholder value, Glass Lewis will recommend shareholders vote against directors responsible for risk oversight. This has been Glass Lewis' policy, and is now stated explicitly in its voting guidelines.

- *Conflicting Management and Shareholder Proposals.* Glass Lewis will examine the following factors in order to determine whether to support conflicting management and shareholder proposals: (i) the nature of the issue; (ii) the benefit to shareholders from implementation of the proposal; (iii) the materiality of the differences between the terms of the two proposals; (iv) the appropriateness of the provisions in the context of a company's shareholder base, corporate structure and other relevant circumstances; and (v) a company's overall governance profile and, specifically, its responsiveness to shareholders as evidenced by a company's response to previous shareholder proposals and its adoption of "progressive shareholder rights provisions."

Auditing Standard No. 18, Related Parties

Auditing Standard No. 18, Related Parties ("AS No. 18"), was adopted by the Public Company Accounting Oversight Board ("PCAOB") in June 2014 and approved by the SEC in October 2014. AS No. 18 is intended to strengthen auditor review of the process by which companies identify, approve, account for and disclose related party relationships and transactions. The standard requires auditors to perform procedures to obtain an understanding of a company's relationships and transactions with its related parties that might reasonably be expected to affect the risks of material misstatement of the financial statements. As part of the procedures performed, auditors are required to obtain an understanding of a company's process for (i) identifying related parties and relationships and transactions with related parties; (ii) authorizing and approving transactions with related parties; and (iii) accounting for and disclosing relationships and transactions with related parties in the financial statements. AS No. 18 requires an auditor to evaluate whether a company has properly identified its related parties and relationships and transactions with its related parties and communicate with the audit committee regarding such evaluation. AS No.18 is effective for audits for fiscal years beginning on or after December 15, 2014, including reviews of interim financial information in those years. Many public companies and their auditors have been in discussions regarding the appropriate actions that should be taken in response to AS No. 18. In this regard, many public companies have been expanding the type of related party/related party transaction information they request from directors/officers (including as part of the company's annual director and officer questionnaire), although there are ranges of approaches that are being followed by public companies in this regard.

If you have questions about the new disclosure requirements or questions regarding the upcoming proxy season, please contact the authors of this overview or any member of our Corporate Governance team.

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