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2020 Proxy Disclosure and 17th Annual Executive Compensation Conferences, hosted by TheCorporateCounsel.net and CompensationStandards.com

Day 3
Hot Topics- 40 Practical Nuggets in 60 Minutes
Date: 09-23-20

Liz Dunshee: Hello everyone, welcome to our last panel of the conference. This is a perennial favorite. We call it Hot Topics: 40 Practical Nuggets in 60 Minutes. However, I must share the caveat that it is unlikely that our speakers will actually get through all of their 40 nuggets in 60 minutes, so you can refer to the course materials which are posted under the More tab on this platform and will also be available on thecorporatecouncil.net and CompensationStandards.com. You can refer to those for their full talking points, for the points that we don't get to, and I will also note, and I'm sorry to spoil the surprise, but there are 41 nuggets in there because Kyoko was an overachiever and came up with 11, and so there are 41 nuggets in the course materials, we'll get through as many as we can, during the next 60 minutes. Thank you to Bob Lamm of Gunster, Bob McCormick of PJT Camberview, Rob Neis of Eversheds Sutherland and Kyoko Takahashi Lin of Davis Polk. I will turn it over to Bob Lamm to start with the first nugget.

Bob Lamm: Thanks so much, Liz. I'm going to start out with a reference to a really cheesy 1970s TV show called Fantasy Island. Most of you in the audience are probably too young to remember the show, at least for your sakes I hope you were too young to remember it, but every week a group of tourists flew to this resort each week to play out humdrum fantasies, usually to realize that their actual lives were not so bad after all, but I refer to this show because the opening scene featured a diminutive actor named Herve Villechaize at the top of a bell tower spotting the plane that was bringing the soon-to-be disappointed but wiser souls, shouting "Ze plane, ze plane!" I don't know whether any of the visitors to Fantasy Island arrived on a corporate jet, but if they did I hope their companies reported their travel as a perquisite, and that's the subject of my first nugget. Companies continue to get into trouble for failing to report perks, most recently in a June 2020 enforcement action involving Argo Group. Argo failed to report 5 million in perquisites provided to the CEO, including personal use of corporate aircraft, and the penalties included a $900,000 fine. For those of you who prepare your company's proxy statements or your client's proxy statements, you need to make sure that perks are reported. That's your job.

Some pitfalls and pointers, if I may. First of all, the SEC rules do not define or provide much clarification as to what constitutes a perquisite or other personal benefit. The subject was addressed in the adopting release for the current executive compensation

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disclosure rules and it's also been covered in a number of speeches and other statements by members of the SEC staff. One of the most famous quotes is that "an item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties." They've also said otherwise an item is a perquisite or personal benefit 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 convenience of the company unless it is generally available on a nondiscriminatory basis to all employees. I won't try and analyze that statement in detail because we don't have the time, but again it is noted on several occasions that if an item is not integrally and directly related to the performance of the executive's duties it is still a perk, even if it may be provided for some business reason for the convenience of the company. So, for example, an executive going on vacation and taking the corporate jet so that he or she can get back in the case of a last-minute emergency does not make that travel into business travel.

Second pointer is that the SEC rules about disclosure of perquisites are based upon their incremental cost, and this differs from the IRS approach which is based upon the value received by the individual, so for tax purposes and for SEC purposes it really needs to be looked at in different ways. Many of the SEC rules governing personal use of corporate aircraft entail some pretty complex issues. One of the most thorny that I've had to deal with is how you determine incremental cost, and if you're not well-versed in the area it's important that you bring in somebody who is. I think it's important for you to engage in communications with your clients to make it clear that the definition of perquisites is fuzzy, and I'll give an aside here. We see that the SEC, and I'm sure you've heard this earlier in the program, is leaning more towards principles-based disclosure. Principles-based disclosure is great, but when your clients are accustomed to asking you "Where is the rule that says I have to disclose this?" and you cannot point to a rule, that will make your job harder, and that's certainly true of perquisites. The communications need to go to all interested parties, including your executives, and most importantly the people responsible for recording compensation and benefits for inclusion in the proxy statement, and among other things this will result in your need to overcome any executive's assumptions or senses of entitlement that anything they do that is work-related is not a perquisite. Let them know about the Argo case, among others.

You've obviously got to include perquisites in your annual D&O questionnaires and I would urge you not to hesitate to ask pointed questions on the topic, probably including examples that your executives will have to consider, and tell your executive that they, rather than their assistants, must fill out their questionnaires and an answer like "everything's the same as last year" just doesn't fly, all puns intended. I will also say that this is far easier than said than done. If any of us had invested—invented, rather, a system to force executives to complete their questionnaires accurately we all could have retired years ago. So check with all of your company's internal recordkeeping departments, comp and benefits, payables, and be prepared to ask questions about

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payees or payments that don't sound legit. One very helpful group within your company that can assist you in this is your internal audit team and possibly even your independent auditors to check expense accounts and other records that could yield information about perks. In other words, make this a key part of your disclosure control system. With that I will pass the baton to Kyoko.

Kyoko Takahashi Lin: Thank you, Bob. So I'm going to talk about a topic that I know has come up a number of times during this conference, but as one of my nuggets to really think about whether and how to disclose the company's diversity and inclusion initiatives and efforts, and especially focusing on the inclusion side. Obviously, you know, we've heard a lot about diversity especially given the racial justice issues, the social justice issues that occurred over the summer, you know, it's clear that systemic racism has still persisted. We know also, you know, the research has shown that the COVID-19 pandemic has had a disproportionate impact on women and people of color, and so these are real issues that impact real people and not surprisingly, you know, investors are becoming more and more interested in these topics. The SEC has also, which I didn't have the benefit of when I wrote up my little blurb, but they've also put out a final rule on human capital management disclosure under Item 101.

So this is all just to say that there's a lot of, you know, forces coming together and what companies really need to do is in the first instance, obviously, think about whether the disclosure, whether the information is material to them, and also whether investors would want to hear about this, but if it is the case then this is really the time to, you know, make those disclosures and, you know, there's obviously lots of way s to think about it. The New York State comptroller's office, for example, is focusing on EEO-type of demographic disclosure and things like that, and there's probably different ways to provide that disclosure if it makes sense, but rather than just merely thinking about the demographics, again coming back to this notion of inclusion, can be critically important and that can be something that can differentiate the company. You know, as always I think people have probably heard this before but there's this notion that, you know, diversity is just being invited to the party, inclusion is being asked to dance, and the same thing with a company. You know, diversity is at least getting people into the door but after that what you actually do to mentor your employees, including your diverse employees, what you actually do to promote them, to increase their chances of success and retention and elevation. If you can speak to those kinds of very specific efforts, and depending on the industry, depending on the company, you know, you'll focus on different things. there may be different things that you can provide that really go to that point, and again in an environment where people are interested, including your institutional investors, this may really be the time and place to provide that disclosure.

The other thing to note is that there are also some companies, not a lot or not an overwhelming number or anything like that, at least not yet, but there are a number of companies that are taking the additional step, not only of providing disclosure but literally

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putting their money where their mouth is and also in adding diversity inclusion or some aspect of that as a metric into their incentive compensation programs. You know, usually, you know, we'll see if those kinds of metrics really move the needle at these different, you know, at the different companies, and the industries that are impacted are pretty diverse, actually, pretty widespread, but they, you know, but we'll see if this becomes a growing norm. You know, as with all incentive compensation it's critical that whatever you do is meaningful to the company's strategy and it has a real chance of success and accountability and measurement, and so thinking through this is obviously important but again, just something to think about as we are, you know, going through these times. Over to you, Bob McCormick.

Bob McCormick: Thanks, Kyoko. Thinking about Bob's theme of Saturday night TV I guess we're charged with focusing on things that are exciting and new, so what could be more exciting and certainly new and hopefully novel is coronavirus. I think, you know, the way investors are looking at it is they're sensitive to the need for potential compensation changes but wary of how they're actually made in practice, particularly where there's been adjustments to performance goals. I think there's a need for them to really understand that and I think it really comes down to disclosure, so I think it's going to be essential for companies to not just provide information about what they did but really the how and the why, and those are going to be really important. I think those companies in particular that already made modifications will be held to some level of scrutiny about, you know, "Why'd you make the modifications? Have there been sort of board oversight? Was there an evaluation of whether this needed to be done, you know, sooner rather than later, not waiting for sort of the complete impact of the coronavirus to be seen? Was it **_____ (0:12:15)** a little premature?"

So I think there's sensitivity about changes in comp in general and I think around coronavirus there's going to be a bit of scrutiny. You know, so far we didn't see shareholders making a lot of adjustments, they still are looking for a sound design and good linkage between **_____ (0:12:35)** performance. I think that the tests will be next year when we have the impact of the 2020 performance and 2020 compensation decisions and that's where shareholders are going to be really looking for discussion of some of the justification if there were indeed changes, and I think it's important to recognize that shareholders will be openminded if there were strategic changes, significant impact on a company depending on its industry, but it's going to be clear that disclosure will be paramount in order to get shareholders' support. Rob, let met turn it to you.

Rob Neis: Sure. So my first few nuggets are going to focus primarily on some tax issues that I thought might be of interest. The first one deals with Section 162(m) which is the, you know, 1-million-dollar cap on the deduction of compensation to covered employees. So the Tax Cuts and Jobs Act really significantly expanded the types of companies that are subject to Section 162(m), and so now it's a lot more likely that in an

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affiliated group of companies there will be a publicly held corporation that's subject to the 162m deduction limit. It's not necessarily the parent corporation in the group. In fact, I think it's fairly common these days for a subsidiary to be subject to the deduction limit, but for purposes of determining the covered employees, though, whose compensation is subject to the deduction limit it's very important to remember, and I see people sort of making this sort of mistake a lot, it's only the compensation of the executive officers of the corporation that's actually publicly held that are the covered employees and for whom the deduction is limited. Now, of course all the compensation paid by any entity in the aggregated group sort of counts for purposes of determining who some of the covered employees are, for example, and all of the compensation that's paid by all of the companies in the group is also subject to the deduction limit, but it's only the employees, really only the executive officers, I should say, of the corporation that's publicly held is subject to the limit, so I guess my nugget here is know your executive officers and know what companies they're the executive officers of. That can be really important in determining what type of deduction is capped under 162(m). Now I think I turn it back over to Bob Lamm.

Bob Lamm: Yes, thank you, Rob. I'm going to continue with my references to cheesy TV shows, although Hogan's Heroes may be more stupid than cheesy or both. One of the classic lines from that show was "I know nothing!" The show was popular in the late 60s and early 70s and, get this, was a sitcom about life in a German POW camp in World War II. I'm truly not making this up. In virtually every episode one of the characters, a German guard named Schultz, said in very heavily accented English "I know nothing!" Well, where's the nugget? It has to do with the advice we give to clients to say "No comment," i.e. "I know nothing." Let's be clear, any securities lawyer worth his or her salt knows that sometimes the best thing to say is "No comment" or its equivalent. I've given that advice very often myself. The problem is that in my experience most of the time when a company says "No comment" or "We don't respond to rumors," the rumor is likely true. Conversely when the rumor is just that, a rumor, companies tend to squeal like proverbial stuck pigs. For some reason companies that engage in this sort of behavior fail to understand how it plays out among investors and the media. One thing I've learned along the way is that if you don't tell your story someone else will, and often in a manner that is factually incorrect, not with your best interests in mind, or both. Another lesson learned is that even in those sticky situations where you really cannot comment, try to explain why you can't comment. At times the rationale for not commenting may sound like a copout, like "We're still gathering the facts," but being honest with the media and investors, including communicating when you do know some facts, will help you to gain their trust, and trust, frankly, is often the name of the game. Kyoko?

Kyoko Takahashi Lin: So the next point that I'm going to make, if you're following in the outline this is actually point 3 in mine, is this is going to be a year that it may be very important to explain your equity compensation granting methodology. Even if you're

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doing something that's totally business as usual, many, at least for many of our clients they ended up granting their equity awards at their totally normal times in March or maybe even early April when their stock price happened to be at the bottom. Their stock prices have since recovered, for many of them their stock prices have recovered or recovered quite a bit, and so, you know, in hindsight it may look like they were picking and choosing an opportune time to make grants of equity compensation assuming that they were granting it, they divided their stock price into a dollar-denominated value. Again, this may be something that companies do all the time, this may be the time that they always do it, and if that is the case, in next year's proxy statement it will be important to explain that. It may also be helpful if, you know, if in prior years that timing actually happened to hit the top of the market or something close to the top of the market, it may be helpful to just make a note of that, too, just really explaining that the timing of this is just truly business as usual, there wasn't anything nefarious that was going on, but explaining that methodology will be helpful. If you are a company that changed it, for whatever reason, for, you know, if, for example, in order to derive the value you went to some averaging method or you accelerated or delayed your option grants or other equity compensation grants or anything like that, being very clear about what the thought process was to do that is also going to be important as well, so again, just be clear about what you're doing in your disclosure. Bob, Bob McCormick?

Bob McCormick: Thanks, Kyoko. Building a little bit off of that and a little off my initial comments, I would say, you know, given that the bulk of any, and certainly CEO compensation is in long-term compensation there will be a lot more focus on any adjustments to the long-term programs, and I think there's probably more of a open-mindedness among shareholders and the proxy advisors to adjustments to shorter-term 1-year programs with some discretionary aspect built in already about sort of, you know, business operations, unforeseen circumstances that that sort of are reflected by, you know, situations like we're dealing with, with the pandemic. When it comes to long-term programs there's more of a skepticism in that the programs are designed to generally last at least 3 years, at least that's preferred timeframe for most shareholders. They're based on sort of longer-term understanding of strategic initiatives and they've been often in place for many years, so shareholders may be a little more skeptical in terms of changes to those, certainly made based on a short-term impact. So I think there'll be really a heightened scrutiny for those that make changes to the equity programs that are meant to pay out over the longer term.

You know, Kyoko brought up the really important point of, you know, if there's typical grants made at the same time every year and because of the, you know, variations in stock price the grants are much larger for 2020 based on the valuation needing to, you know, grant additional shares, that's something that I think will warrant better discussion rather than just say this is, you know, automatically what we always do, right? I think having some discussion about recognizing this as a sort of aspect of, unintended, of course, of how it worked in practice will be important, and I think ultimately, you know,

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the proxy advisors are going to be looking at… the proxy financial advisors, you know, where there changes of the timing? So the opposite of what I was just talking about. Were there changes to performance metrics? Were there changes to the performance targets? Were there changes to the way the equity is granted? Is it changed from, you know, performance-based to purely time-based? Were there any changes to the performance period to give either an existing award more time to pay out or were there complete cancellation of existing awards and grants of new awards that will take the place of the existing awards?

Now I think in some cases depending on industry this would be palatable to shareholders if, again, there's a really good description of, you know, the reason for that. If you're in the industry that is immensely impacted by the pandemic and the targets are, you know, going to be impossible to meet the whole incentivizing aspect, retention aspect of the awards are completely destroyed, then I think there'll be more of an open-mindedness to these sorts of changes. However, if there's more of a sense that this was a quick reaction to a pandemic or global economic situation that's still yet to play out there'll be more skepticism. So I think, you know, looking at how long-term compensation works shareholders are already encouraging more performance aspects, so any changes to those performance aspects are going to be sort of met with a little bit of skepticism, and in some cases it'll be a high bar for shareholders to accept those changes without some really strong rationale, and I think engaging with the shareholders, letting them know the rationale behind the changes to the long-term program will be even more important than changes to the short-term program. Rob?

Rob Neis: Oh, thanks. I have one more point I wanted to make about 162(m). So there's a quirk in the proposed 162(m) regulations. Under certain circumstances if there are multiple publicly held corporations in a single affiliated group and there is an executive officer who happens to be a covered employee of more than one publicly held corporation in that affiliated group and he or she is being paid by both of the corporations, under the deduction allocation rules in the proposed regulations the deduction for that individual's compensation can actually be reduced to less than a million dollars under these circumstances, and in fact can be reduced to zero in some cases. You know, that may not actually matter all that much given the deduction that's already being lost under 162(m), but it's certainly something to keep in mind and you know, in particularly in determining sort of who may be appointed to be the executive officers of different companies in a group. We've actually asked the IRS to reconsider the way this rule works and to ensure that at least a million dollars is available as a deduction for covered employees' compensation, but we'll just have to see where that ends up in the final rules, which we're expecting later this year. I think Bob Lamm, you're up next.

Bob Lamm: Thank you, Rob. I'm going to depart from stupid TV show quotes, although I have a few more in the hopper that'll come back later. Instead I want to refer

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to a quote from a statement made in April 2020 by SEC Chair Jay Clayton and Corp Fin Director Bill Hinman. The quote is “Historical information may be relatively less significant.” This sort of harks to some of the points that Bob McCormick has made, this point and last point, because they’re really words to live by as we continue to deal with a pandemic, social unrest, a consequential election and heaven knows what else. I think we’re up to plague number 4 now in the biblical sense, so I think it’s important to keep this in mind as you prepare your disclosures going forward. Historical information, in my view, will continue to be less relevant. There has already been some degree of investor pressure over the last maybe 20 years to depart somewhat from the historical financial statement model to give more information about what’s expected in the future, and in the wake of COVID-19 and everything else that’s happened it seems important, more important than ever that companies depart from just looking backwards and have more forward-looking information. In fact, it’s arguable that Clayton and Hinman are beginning a process in which the SEC will regard historical information as increasingly less significant and that forward-looking information will become the norm or closer to it, and again I want to hark back to the earlier comment about principles-based disclosure. Clearly principles-based disclosure is in some senses intended to be more forward **_____ (0:26:55)** again, things can change as a result **_____ (0:27:01)** think it’s inevitable that we’re going to continue to see more pressure for this going forward and you need to think about your disclosures accordingly. Kyoko?

Kyoko Takahashi Lin: So my next nugget has to do with a point that David Kokell made at last year’s conference and also just in the past session about ISS and Glass Lewis. So, you know, as a number of clients learned and a number of companies learned, you know, when ISS said that they were going to be taking seriously what you disclosed about separating executives, departing executives, you know, they really did mean it. They had put in an FAQ in their compensation policies for this past proxy season and they stood by them, and so when companies actually did not provide disclosure and sort of suggested that the departures were either mutual or, you know, sort of less than involuntary but yet the executives received severance anyway, ISS called them out and in some cases made negative recommendations on their Say-on-Pay vote, actually. This is something that we had anticipated would continue and David just reinforced that in the session that we had, that preceded this one, so it’s something that I think it’s worth paying attention to. You know, it can lead to awkward conversations and perhaps even disclosure, because before you could sort of neatly brush everything under the rug and say that, you know, the person was just departing or separating and use fairly neutral terminology, and there may still yet be a basis for doing that, but if you are paying out severance and you, you know, and it’s under the severance plan, for example, and it looks like, you know, if all your other public disclosure really makes it sound like it’s a totally voluntary departure or retirement or something along those lines and then that’s not the case, just be prepared for the potential consequences from that, and so it’s really, you know, a weighing of, you know,

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the moment of what you actually say versus, you know, do you want to it to haunt you when the potential votes are coming in? Bob McCormick?

Bob McCormick: Thanks, Kyoko. So, you know, one of the terms that we're starting to hear more consistently is human capital management. I think if you, you know, look back a couple years the comp committee was responsible for, or the _____ **(0:29:58)** was responsible for the compensation of NEOs and they met fairly infrequently to discuss that and then kind of moved on to other issues. Now there's a much higher expectation among shareholders that the board and the comp committee in particular is responsible for the human capital management of the entire firm. That is, are there initiatives, programs, policies in place to ensure that the firm is attracting, retaining, promoting, creating equal opportunity for employees really at all levels? So this idea that it goes beyond even just compensation, of course, this year, with the pandemic.

So I think many companies have done a really good job of explaining, you know, the safety steps they've taken to ensure that employees continue to work in safe environments. I think minutes will be top-of-mind for a lot of investors and I think for office-type jobs it's kind of an easier explanation. I think it's those maybe in manufacturing plants or oil rigs, for example, where it's a little harder to really ensure the complete safety of employees. Everyone can't work from home, so I think that will be a big aspect of how a lot of investors are asking questions, and I think in the broader theme of sort of ESG issues, if in the past we've spent a lot of time on the G, the governance of, you know, takeover protections, that sort of thing, and then in more recent years the E, sustainability reports focus on environmental impact, the S is really becoming preeminent because of this focus on ensuring employee safety, so I think this has been growing as a topic of discussion and engagements but I think in this year it will be even more top of mind. It's really, you know, what are companies doing to ensure the safety of all employees?

And then underlying that is the social unrest in terms of, you know, Black Lives Matter, et cetera, so were there steps to ensure there's equal opportunity for employees, and for not just attracting them but retaining and promoting them? What we've seen over the years is a lot of focus on diversity at the board level and shareholders saying "All right, we've seen some progress," they're still not satisfied, but are there individuals who can be promoted through the ranks up and be sort of in that pool of candidates that could potentially be nominated to the board, and how is the board in the company approaching that? So all of this really falls under this very broad topic of human capital management that has been sort of developing as an issue, but with the results of the pandemic it's really heightened a lot of attention on this, and I think will be pretty standard part of a lot of engagements, again, much more than just the compensation aspect of the executives but really or even the compensation for the broader employees but also more sort of broader employee treatment.

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Bob Lamm: Yeah.

Bob McCormick: Rob?

Bob Lamm: Hey, Bob, sorry to interrupt but, you know, a couple of observations,

Bob McCormick: Sure.

Bob Lamm: If I may. Number one, there have been suggestions that ESG be redesignated EESG,

Bob McCormick: Right.

Bob Lamm: One or the other of the E's to stand for employees. You know, in addition to board diversity which traditionally—I shouldn't say in addition to, as part of board diversity which in the last few years has been almost exclusively focused on gender diversity, you're seeing some companies step up to the plate and where they are the investors providing pressure to diversify boards racially as well as in terms of gender, and the last observation I'll make is that I've started haring rumblings of questions about whether the title "compensation committee" needs to be changed to reflect what appear to be growing responsibilities of that committee with respect to human capital, diversity, equity and inclusion and things of that nature. Right now, you know, names do matter, I suppose, but people are very concerned or at least some people are very concerned that when you say compensation it sounds like the company and the board is only focused on money, and while that may be true they want to put out a better image, so some name changes may be in the works.

Bob McCormick: Yeah, I think there's a handful of more progressive companies that have already done that,

Bob Lamm: Yeah. Yeah.

Bob McCormick: But that's a great point, basically kind of memorializing what they're starting to do anyway.

Bob Lamm: Yeah, exactly, exactly. Sorry, Rob, please go ahead.

Rob Neis: No, that's okay. Interesting discussion. So my next nugget is on withholding and RSUs. So the IRS recently released, issued a generic legal advice memorandum explaining that employers that pay stock-settled RSU's at the time of vesting have to use the values of the shares on the vesting date to determine the amount that's subject to withholding, and I think that this was a bit of a change. I think previously there were a lot of folks who believed that the value of the stock with stock-settled RSUs was really

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determined when the stock was actually deposited into the account of the employee and that that was the value that was used for withholding and other purposes, and of course I think this was based on kind the general rule that compensation's includable in income when it's actually or constructively received. The nuance in the logic of this IRS memo is that the IRS considers kind of payment to be made in the case of RSUs or even options or SARs when the process of transferring the shares to the employee begins, when that process commences, and not when it ends, when those shares finally hit the employee's account. In some ways I think this makes withholding a little bit easier, since the value of the shares is known at the time the process starts, and it gives folks a little more time to calculate the amounts that need to be withheld and deposited. Bob, I think, Bob Lamm, I think it's you.

Bob Lamm: It comes back to me again. This may be my last TV quote but it's a much better show, Saturday Night Live, and the quote is one word, "Discuss," as in Coffee Talk with Linda Richman, and this is all about the MD&A, which again stands for Management Discussion & Analysis. Now this is a pet peeve of mine because I've read lots of MD&A's in my time and to be completely candid many of them, or at least too many of them, are pretty lousy. Maybe the good news for people like me bearing this grudge is that the SEC is reexamining some of the most important disclosures companies provide, namely the MD&A. I'm going to cite some ways in which I've found MD&As are poor. Number one, they don't provide the A in MD&A, the analysis. "Sales are up." Great, why were they up? Anyone's guess. One of my favorite lines here is "increased market acceptance of our products and services." Well, that's great, but what does that mean? Were more units sold? Were customers willing to pay more per unit so the company raised the price? The company expanded the markets in which its product is sold? Beats me.

Similarly, instead of discussing the why's companies do a cut and paste of key line items in their financial statements. If they're really fancy they put a percentage change column next to it indicating how much each line, say in the P&L, changed from period to period. In other words they're doing exactly what any reader can do, which is precisely what the SEC has said you're not supposed to do, and then they copy and paste sections of the notes to financial statements about how revenue is determined. Again, no why. I won't go on with this litany of horrors, but I suppose I could. I've frankly been very surprised that the SEC has not been more vocal about MD&A disclosure. There have been a few interpretive releases that have said "No, that's not really what we meant," and there were some enforcement actions, one notable one being against Caterpillar which goes back to 1992. Caterpillar did not disclose problems with its Brazilian operations even though concerns about those operations had been the subject of serious board discussions. Companies may have decided as a result of the SEC's relative inactivity in the area that the SEC wasn't really interested in MD&A disclosure. By the way, one practice point arising out of Caterpillar is that when I was in the process of drafting my company's MD&As when I was in-house, I would always go through the board minutes one more

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time or the audit committee minutes just to see what it was that they'd focused on so that I could at least ask the question what's going to be included in the MD&A and if not, why not?

In any event, if anybody's been thinking that the SEC is inactive and isn't interested in this area, that's changed. First in late January 2020 the SEC issued some proposals that would streamline MD&A that would make it more meaningful. They would eliminate some current disclosure requirements and would also eliminate the need for selected financial data and summary financial information. So, so far so good, no bad news there, but the less good news came later in the year, specifically February 19th just before the COVID pandemic geared up and hit us in the head. The SEC announced the conclusion of an enforcement action against Diageo PLC, a purveyor of spirits, wine, and beer. Diageo was a foreign private issuer but the language in the SEC's report would be equally applicable to any US issuer. I'll just quote some excerpts from it. "Diageo failed to make required disclosure of known trends and uncertainties, thereby rendering its required periodic filings materially misleading. Diageo said 'North America again delivered top-line growth driven by 5% growth in spirits and wines. Our strength and innovation has continued.' This statement was rendered misleading by the fact that a significant portion of North America's top line growth was from over shipping, primarily new products." Another quote. "Diageo failed to disclose the trends of shipping in excess of demand and the resulting inventory bills, the positive impact those trends had on sales and profits, and the negative impact they reasonably could be expected to have on future growth, and the fact that they caused Diageo and DNA, Diageo North America's reported financial information to," I love this line, "not necessarily be indicative of future operating results or financial condition."

Now you can argue, and many people have, that Diageo's situation was less about disclosure than questionable business and accounting practices that the SEC was concerned about Diageo's disclosure controls and so on, but the report certainly seems like a shot across the bow to issuers that the MD&A isn't supposed to be a puff piece, and then just a few days later the SEC issued an interpretive release containing guidance on disclosures of key performance indicators and metrics in the MD&A. The release notes that companies should identify and address those key variables and other factors that are peculiar to and necessary for an understanding of the evaluation of the individual company such as key performance indicators and other metrics, and points out that some companies provide both financial and non-financial metrics. A couple of additional high points from this release, the SEC reminded companies that when including metrics in their disclosures they should consider existing MD&A requirements and the need to include such further material information as may be necessary in order to make the presentation, in light of the circumstances under which it's presented, misleading. The SEC also said "We would generally expect the following disclosures to accompany the metric: a clear definition of the metric and how it's calculated, a statement indicating the reasons why the metric provides useful information to investors,

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and a statement indicating how management uses the metric in managing or monitoring the performance of the business."

The second bullet above, namely why the metric provides useful information, is a particular sore point with me because many companies give no reason why the metric provides useful information or give a non-reason such as, and this is a direct quote, "Some investors may find it useful." Obviously the release points out that—I shouldn't say obviously, but the release does point out that non-gap metrics call for the same information, so if you're going to use these metrics, try to put some meat on the bones about why it's actually meaningful, not necessarily because some investors may find it useful but, for example, you know, "investors have told us that they find it useful," or "we used this metric in looking at our performance and analyzing how to increase performance." With that, Kyoko, back to you.

Kyoko Takahashi Lin: So I'm going to continue with my theme of executive terminations, so if and when a company does decide to pay severance to an outgoing executive, regardless of what the basis for the termination might be, and if the person's an executive officer and especially if the person may be in the zone for becoming a named executive officer, the timing of the payments, the manner of the payments, the conditions of the payments can all have an impact on how those severance amounts actually get reported in the summary compensation table, especially for the summary compensation table for the year in which the termination actually occurs, and this can impact, actually, who your named executive officers are. You know, your named executive officers obviously include your CEO, anyone who served as the CEO, anyone who served as a CFO, 3 of your current executive officers depending on what their compensation levels are, and then up to 2 additional executive officers who would have made it into the table but for the fact that they were no longer serving in the year, and every year we have companies that are surprised that it's actually the severance amount that can cause someone to, you know, make it into the table, which then has a lot of knock-on effects in terms of 8-K disclosures and exhibit filings and other things like that, sometimes even well after the person has ceased being employed by the company anymore.

So in the first instance, you know, whether or not the person makes it into the table, that might be manageable to some extent by, for example, paying out their severance over time and especially if the severance is conditioned on the person's compliance with restrictive covenants, like a non-compete or something along those lines. Of course, there are some states where non-competes are not enforceable, and so if that's the case and that's not very helpful, but where they are, where they can be enforceable, that can actually cause those payments that are made outside of the company's fiscal year still subject to the covenants to not count as, for example, 2020 compensation. If you have, you know, again, you know, if the person is a named executive officer and severance is paid then that can result in not only summary compensation table disclosure but

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obviously disclosure in the potential payments table, there may have to be an 8-K, you may have to have an exhibits filing, so just to think through all of that is important, and one other point that I'll just make which is not actually in the blurb itself, in the written blurb, when you're paying severance to anyone, for that matter, not just an executive officer, but anyone, really think about whether there might be an unexpected 409A consequence associated with that.

If it turns out, for example, that the person was already entitled to some form of severance and as a result of the termination of employment and there's a change, for example, in the treatment of the person's equity compensation or a change in the, you know, how fast the person's going to get paid or anything like that, that can actually sometimes be an impermissible acceleration of deferred compensation or all sorts of things like that, and the rules, I'm not going to go into the rules because they're very technical, but just to know that you know, you should be well-advised as to how to think through that, not only from an SEC disclosure perspective but also from a tax perspective as well because it can be a trap for the unwary. Bob McCormick?

Bob McCormick: Thanks. So what I thought I'd do is in the interests of time maybe combine a couple points that are related, and they're mainly around ENS or ES&G. So I talked a little bit about the human capital management. I think what investors are beginning to look for more consistently is sort of put it under the rubric of, you know, never measured, never managed is that unless you have an E&S metric in your compensation program as some sort of target then the executives and employees are really not going to take that seriously. So they're asking more questions within the sort of broader concept of human capital management is all right, you know, how do you ensure that employees are focused on ensuring employee safety, good environmental practices, et cetera, et cetera? So they're asking for companies to, in some cases, to assure a proposal process to add some E&S metrics to compensation programs. Now this isn't a new feature of compensation programs, this has been **_____ (0:48:39)** particularly around safety in more shorter-term programs, but we've seen broader pushes on increasing diversity, for example, as an area of requested inquiry from shareholders about, you know, adding some of that to the compensation programs, really promote diversity, and, you know, I mentioned shareholder proposals, there's really a record number of environmental social proposals that passed this year and, you know, expect more next year, nothing succeeds like success when it comes to shareholder proposals, and what we've seen is a lot were around human capital and diversity.

We've seen, you know, strong support for those that are looking for disclosure, significantly less for those that are asking for specific targets or, you know, to actually implement a particular program, but shareholders are really, I think, in many cases looking for very specific areas of disclosure in terms of even around EEO-1 numbers and that will be, I think, a campaign we may see, a significant number of share proposals

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asking companies to disclose their EEO-1 data really with the idea of trying to compare companies, not just on an annual basis but year over year in terms of trends, in terms of improving their diversity, and diversity at all levels. I think this is part of a broader theme of more shareholder focus on E&S programs. We've seen this become a pretty standard part of engagements and, I think, you know, companies have been really responsive to that. I think many times companies already have good programs in place, they just maybe haven't disclosed them or maybe disclosed them in as prominent a way as they might, so it's really helping companies think through well, you know, if you put it more prominently or add some information to the proxy, maybe a link to where there's more information, that could be really helpful about, you know, how the company's designing its E&S programs and a lot of focus even very recently on targets for going carbon neutral in a certain timeframe and percentage of you know, steps towards that targets, and so these are all issues that shareholders continue to keep top-of-mind and it does tie back to disclosure, back to kind of my initial point, is shareholders are saying "well, let's put some sort of teeth behind some of these targets or goals or initiatives." It's all well and good to, you know, say you're going to be doing this but unless you're actually compensated for it you probably won't be as aggressive towards reaching these targets. So that's where we've seen a lot of shareholders push and I think we'll continue to see more push next year based on what we've seen so far in terms of support for some of these proposals this year.

Bob Lamm: Yeah, and—

Bob McCormick: Rob?

Bob Lamm: Bob, again, apologies for interrupting but I think you're seeing a sort of concomitant increase in the expectation that these ESG numbers, particularly if they're going to be used as compensation metrics, receive some sort of auditor-type assurance. You know, I think just today or yesterday, I'm way behind in reading my emails, but I think the Big Four just came out with some sort of statement or policy yesterday or today about the nature of assurance. The assurance documents that I've seen thus far bear a tremendous resemblance to the really old-fashioned comfort letter, where, you know, every number had to be tied back to the financial records of the company. They're obviously not in a position, at least not yet, to comment on the appropriateness of the metric for compensation or other purposes but, you know, candidly I think the audit firms are interested in this as a source of additional revenue and I think it's really relevant that the investors are asking for more of this short of thing, so again apologies for that but I thought it might be worthwhile for people to know that. Rob?

Rob Neis: Thanks. So I'm going to stick with the theme of withholding on RSUs for just another minute, this time, though, focusing on the timing of withholding. So as I mentioned previously the IRS takes the position that withholding on RSUs is based on the value of the shares when the settlement process starts and not when it ends, so that

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same IRS memorandum takes the position that it's the start of the settlement process that you look at for purposes of determining when employment taxes are due. Now, in the case of, you know, larger employers with $100,000 or more in employment taxes that are due, those taxes are generally due on the next business day. Kind of one other, just shortly after the IRS memo came out the IRS also updated some of its internal procedures, and that wasn't very well-advertised but basically what the IRS said was that for purposes of determining the due date for employment taxes on RSUs, stock options that are exercised and SARs, basically the due date can be the settlement date for the transaction, provided the settlement date's consistent with the SEC's kind of current settlement cycle rule that requires settlement within 2 days of the transaction date. So basically, then, putting this all together, the employment taxes are due on RSU's, stock option exercises and SARs basically on the first business day following the settlement date, provided the settlement date's no more than 2 business days after the transaction date. I think Bob, you're—

Bob Lamm: Yeah, we've got 5 minutes left so I'm going to be hasty. My last quote is from Monty Python and the Holy Grail and the quote is "I'm not dead yet," and that refers to the fact that companies refuse to eliminate unnecessary disclosure on compensation committee interlocks and insider participation from their proxy statements. I've railed about this, I think, for the last 4 conferences. I'm going to do it again because I still keep seeing that pesky disclosure. I know what the rules say but the FCC has issued an interpretation that the disclosure can be omitted if there are no such interlocks or participation, and the **_____ (0:55:51)** is in the materials, so take it out, and with that I'll pass it along to Kyoko.

Kyoko Takahashi Lin: So this is really fast and, you know, if there is a transition in the company either among your executive officers or the directors, just remember to update the external website. A lot of times companies are so focused on all the legal requirements and all the compliance requirements that something as, you know, as very minor then, you know, like that, but that's actually important to the rest of the world can just get forgotten, you know, by the wayside, so just a note to remember to update that website. Bob?

Bob McCormick: Thanks, Kyoko. So just the last thing I want to touch on, much more shareholder focus on understanding pay equity. There's been pushes over the last couple of years for companies to disclose more information about how compensation is broken down by gender and then more recently by ethnicity or race. The focus is on ensuring that not only are there good hiring practices for underrepresented groups but are they paid fairly, and what we've seen is some shareholder proposals on these matters have gotten significant levels of support. So some of the shareholders submitting these proposals are on the smaller side but they get a tremendous amount of attention and ultimately the proposals themselves are getting high levels of support from some of the biggest investors. So the focus initially was on the pay gap reporting, that

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is, you know, the gap between men and women and we've seen this taken up by some companies have voluntarily done it, others have done it as a result of discussions with some of these shareholder groups, and other markets like the UK it's required disclosure. When I think, given the themes this year of, you know, racial injustice and human capital management, I think it will probably be even more top-of-mind for shareholders who are saying "All right, let's ensure that not only is it equal to opportunity but that people are paid equally," and I think most companies, again, have a pretty good story to tell at the more sort of junior midlevel ranks, probably less compelling evidence among the more senior execs and I think, however, that there's a lot of good trends that we've seen among our clients. So I think that's an issues we that will continue to be focused on. Rob?

Rob Neis: Well, I'm going to skip ahead to a topic that I might actually be able to cover in a minute and a half, and that is, and again, sticking with the theme of Restricted Stock Units or RSUs. Some RSUs are treated as deferred compensation and are subject to the rules under Section 409A, which I'm sure everybody is very tired of hearing about, so I won't go into those rules in any detail, but typically the RSUs that are subject to 409A are ones where the RSU vests, you know, in one year and the amount is paid out in another year, or you know, after a fairly significant period of time. If they're paid out in the first part of the year you don't trigger 409A, but if they're paid out a little bit later you might. Anyway, this delay between vesting and payment is where I often see folks trip up a bit. Sometimes the RSUs vest and then people kind of forget to pay them when they're supposed to be paid or transfer the shares. Sometimes they vest and folks want to accelerate the time that the shares are transferred or the amounts are paid because, for example, somebody's leaving or there is some other exigent circumstances. Both of those situations can lead to Section 409A violations.

What I recommend for, you know, all my clients who can do it is to do basically an audit of your RSU programs and your deferred compensation programs generally annually to try to catch these errors as they occur. If you catch them in the same year that they occur the IRS has a correction program where you can sort of be largely relieved of the the more significant penalties that apply when 409A is violated and the correction is pretty easy. If you wait until the following year you can also correct under certain circumstances, but the people for whom you can correct is more limited and the penalty relief is much more limited, and if you wait beyond that then correction gets very hard to impossible. So doing an annual audit of your RSU program and your deferred compensation program is definitely something to keep in mind and do if you can.

Liz Dunshee: Thank you. That was—

Bob Lamm: **_____ (1:01:07)** on the nose.

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Liz Dunshee: Yeah, that was impressive that you wrapped it up here on time, but also I don't think I knew about that IRS correction program, so that's really helpful information to know about. Thank you for sharing that. Thank you Bob, Bob, Rob and Kyoko. I was joking before we came on that I didn't realize until I was putting together the course materials that we had so many similar names on this panel, so I hope everyone was able to keep up and I also did just want to plug, since Bob McCormick mentioned pay equity, that is the topic that we have been covering frequently on CompensationStandards.com, and we actually have a webcast coming up on that topic on November 19th where we will be covering that in detail, pay equity, what compensation committees need to know, so make sure to mark your calendars and tune in for that. Again, this was an awesome program and I thank al of our speakers. Thank you all.

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