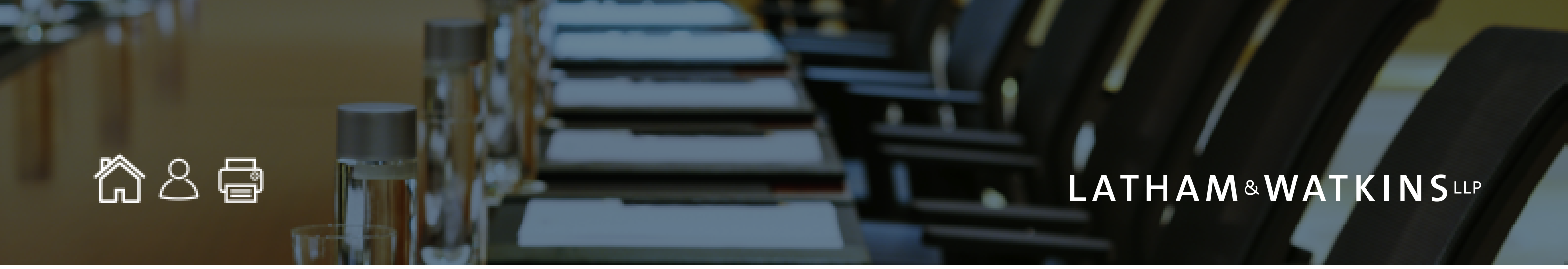
LATHAM & WATKINS LLP

Key Compensation Items for 2024 Proxy Season and Beyond

A summary of the key executive compensation-related reminders and considerations that public companies should continue to prioritize early in 2024 and in preparation for the 2024 proxy season.

February 2024

Contents



Pay Versus Performance Disclosure

Pursuant to rules that the Securities and Exchange Commission (SEC) issued in late 2022, publicly traded companies must generally provide both tabular and narrative and/or graphical disclosure of the relationship between executive compensation that the company “actually paid” to its named executive officers and the company’s performance over a specified time period (“pay versus performance” disclosure). This pay versus performance disclosure is not required for emerging growth companies, foreign private issuers, or registered investment companies. For a more detailed discussion of the rules, please refer to this Latham Client Alert.

To address open questions regarding compliance with the new rules, during 2023, the SEC issued new Compliance & Disclosure Interpretations (C&DIs) along with several comment letters to issuers.

Notable new C&DIs provided that:

- The pay versus performance disclosures are not required to be included in Form 10-K.
- Footnote disclosure of each of the amounts deducted and added for purposes of calculating compensation actually paid for years other than the most recent fiscal year is only required if it is material to an investor’s understanding of the information reported in the pay versus performance table for the most recent fiscal year, or of the relationship disclosure.
- For newly public companies, if the class of securities was registered under Section 12 of the Exchange Act during the earliest year included in the pay versus performance table, the “measurement point” for purposes of calculating TSR and peer group TSR should begin on such registration date. Additionally, for outstanding stock awards and option awards, the fair value calculations for awards granted prior to the date of a registrant’s initial public offering should be determined based on the change in fair value from the end of the prior fiscal year and should not be determined based on the date of the registrant’s initial public offering.
- If the company’s stock price is a market condition applicable to an incentive plan award, or is used to determine the size of a bonus pool, it can be included as the company’s Company-Selected Measure. Additionally, the Company-Selected Measure can be any financial performance measure that differs from net income and cumulative total shareholder return, including a measure that is derived from, a component of, or similar to those required measures. The Company-Selected Measure included in the pay versus performance table is the measure for the most recently completed fiscal year and cannot be measured over a multi-year period.
- For pay versus performance purposes, if retirement eligibility is the sole vesting condition, this condition must be considered satisfied for purposes of the calculation of compensation actually paid in the year that the holder becomes retirement eligible. However, if retirement eligibility is not the sole vesting condition, other substantive conditions must also be considered in determining when an award has vested. Such conditions would include, but not be limited to, a market condition or a condition that results in vesting upon the earlier of the holder’s actual retirement or the satisfaction of the requisite service period.

- If certification of the performance-based vesting conditions of an award is an additional substantive vesting condition, then the award would not be considered vested until such certification has occurred, and certification requirements will need to be evaluated to determine if they create an additional substantive vesting condition (such as a requirement for continued employment through the date of such certification).
- The methodology and assumptions used to compute the fair value of stock and option awards for purposes of calculating compensation actually paid must be consistent with GAAP (generally accepted accounting principles) and FASB ASC Topic 718.
- The pay versus performance rules require disclosure of any material differences in the assumptions used to calculate the equity award values for purposes of compensation actually paid and those used to calculate the grant date fair values reported in the registrant's financial statements (including changes in probability of achievement of performance awards year to year). Companies may omit footnote disclosure of valuation assumptions like expected payouts on performance conditions if the issuer can demonstrate that such disclosure would create competitive harm. However, companies must still provide as much information as possible without creating competitive harm, such as:
  - a range of outcomes or a discussion on how a performance condition impacted the fair value; and
  - how the material difference in the assumption affects the difficulty (or likelihood) of achieving the undisclosed target levels.
- Disclosure of incentive plan target/attainment levels that are non-GAAP financial measures in the CD&A is not subject to Regulation G and Item 10(e) per Instruction 5 to Item 402(b). The SEC clarified that this also applies to non-GAAP measures presented in the pay versus performance disclosure. The disclosure must still provide how the number is calculated from a registrant's audited financial statements (which may be cross-referenced to another section of the proxy, but not another filing). Non-GAAP financial information that does not relate to the disclosure of incentive plan target/attainment levels or pay versus performance disclosure that is nevertheless included in the proxy statement needs to comply with Regulation G and Item 10(e). This includes, for example, measures included in an executive summary or to explain how pay is structured. However, in these pay-related circumstances only, companies can include Regulation G and Item 10(e) information in an appendix to the proxy statement or provide a prominent cross-reference to the pages in the Form 10-K containing the required information.
- Dividends and dividend equivalents paid on the underlying shares of stock awards must be included in the compensation actually paid in the year paid if not already included in the fair value of the awards or included in another component of total compensation.
- A broad-based index cannot be used as the TSR peer group in the pay versus performance table.
- Smaller reporting companies (SRCs) that lost status as of January 1, 2024 may provide another year of scaled disclosure and only include disclosure covering fiscal years 2021, 2022 and 2023, and will be required to include full disclosure commencing with the proxy statement filed in 2025 covering fiscal year 2024.

The SEC's comment letters on pay versus performance disclosures focused primarily on the following:

- Disclosure issues, including failure to include all required disclosure elements (e.g., footnote disclosure regarding adjustments to "compensation actually paid," disclosure of how non-GAAP measures selected as the company-selected measure are calculated from GAAP financial statements, and the tabular list of 3-7 financial performance measures used to link the company-selected measure with company performance), failure to include or identify the relevant executives or peer group companies, failure to include the company-selected measure in the list of 3-7 most important financial performance measures, and insufficient disclosures on the relationships between compensation actually paid and net income or the other relevant measures.
- Calculation issues, including use of a TSR peer group that does not match the industry or line of business peer group used for the Form 10-K performance graph or the compensation peer group used in the compensation, discussion, and analysis (CD&A), not using the correct Summary Compensation Table amounts in the calculations, and failure to value awards as of the vesting date rather than year-end.
- Presentation issues, including using incorrect terminology or table headers and failure to comply with the XBRL tagging requirement.

Proxy Action Item

The pay versus performance disclosure obligations require advance planning and effort for the 2024 proxy season. For example, companies will need to undertake a number of fair value calculations under Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 718, Compensation—Stock Compensation (ASC Topic 718). Companies should also review SEC guidance issued in 2023 to confirm its applicability to their 2024 pay versus performance disclosure and make any necessary adjustments in light of that guidance. Companies should prepare to provide complete and effective pay versus performance disclosure for the coming proxy season.

Clawback Policies

In October 2022, the SEC adopted final rules directing the stock exchanges to issue rules requiring publicly traded companies to implement policies to recover incentive compensation that current or former executive officers received erroneously during the three-year period preceding the date the issuer must prepare an accounting restatement (including both “Big R” and “little r” restatements), without regard to any misconduct. The new clawback policy rules apply to nearly all listed issuers, including smaller reporting companies, emerging growth companies, and foreign private issuers.

The NYSE and Nasdaq clawback listing standards went into effect on October 2, 2023. **Issuers were required to implement a compliant clawback policy by December 1, 2023.**

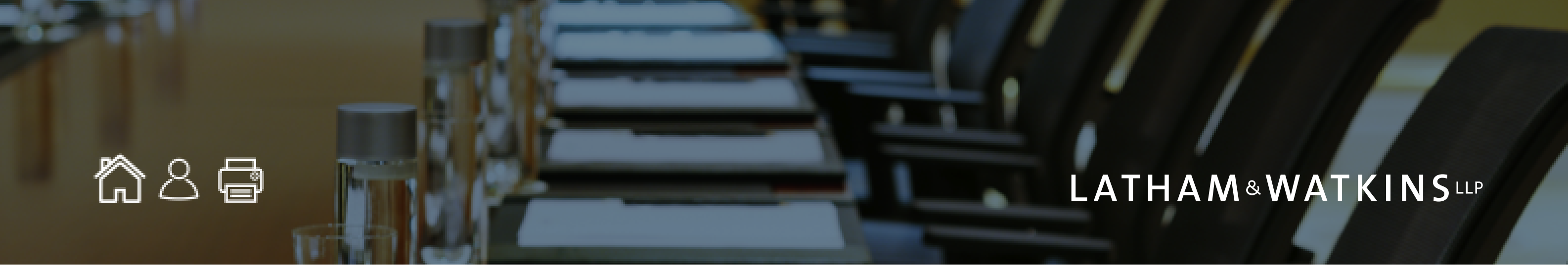
NYSE-listed issuers were also required to submit an affirmation to NYSE’s Listing Manager by **December 31, 2023**, that affirms the issuer timely adopted a compliant clawback policy. Nasdaq currently does not have a similar requirement.

A company’s clawback policy must be filed as an exhibit to a company’s upcoming Annual Report on Form 10-K. Form 10-K has also been updated to include two new check boxes on the cover page indicating whether the filing contains the correction of an error to previously issued financial statements, and whether any of those corrections involved a restatement that triggered a clawback analysis.

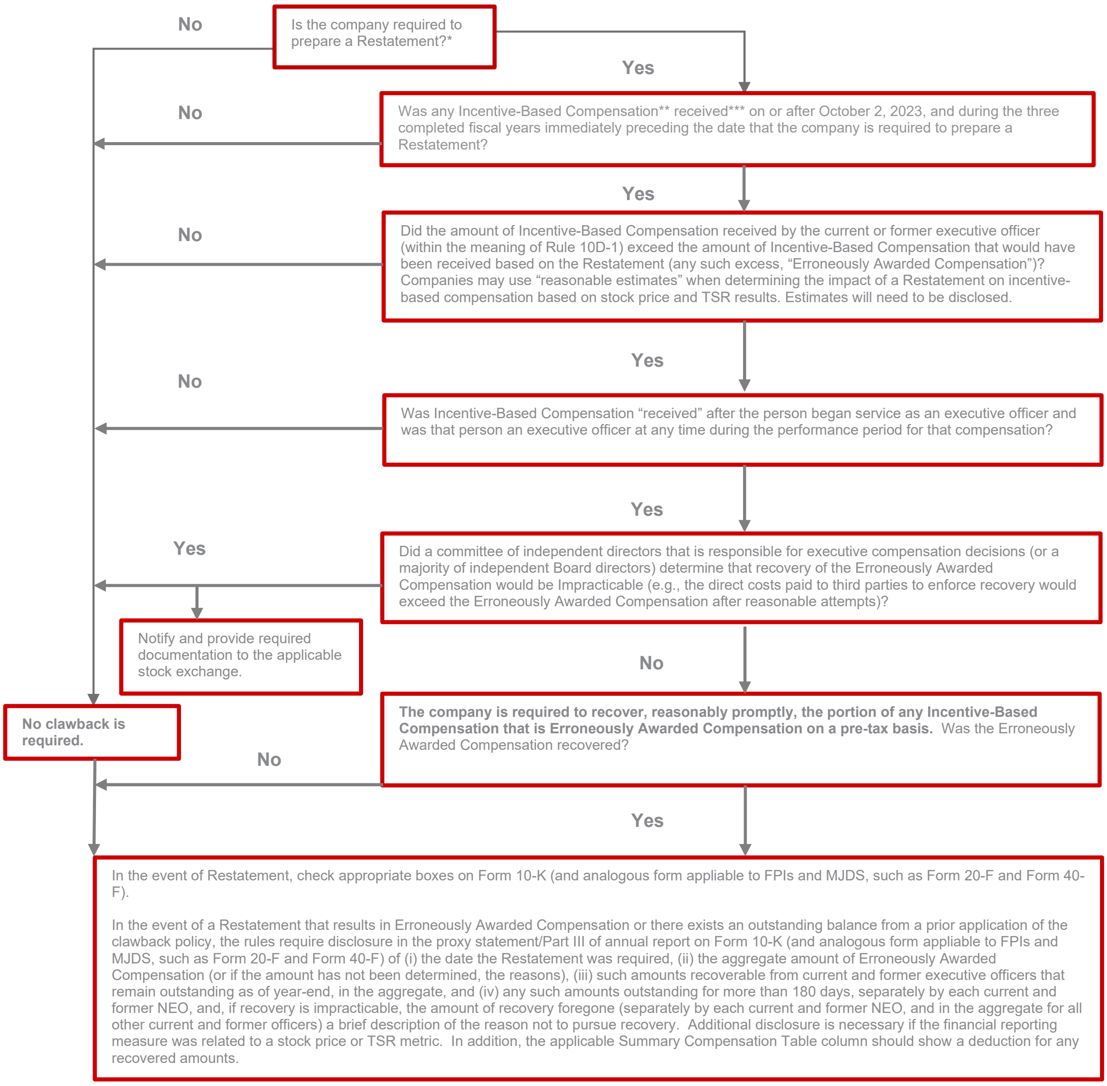
After adopting a clawback policy, companies should ensure that they have procedures in place to implement and comply with the policy in the event that a statement is determined to be required. For example, companies should evaluate the impact of the clawback rules on existing and planned incentive-based compensation programs and ensure that incentive-based compensation is properly identified and tracked. Companies should also ensure that executives subject to the policy, as well as the company’s finance, legal, and accounting teams, are aware of the new rules. The nature of a no-fault clawback policy triggered only by accounting restatements puts increased pressure on directors and employees who are responsible for reviewing financial statements and the materiality of any errors. As a result, companies should consider reassessing their financial reporting function to ensure that they are appropriately investing in sufficient personnel with the necessary expertise in GAAP or IFRS requirements and robust internal control over financial reporting, which is every company’s first line of defense in avoiding financial statement errors.

Note that foreign private issuers, which are not subject to Section 16 of the Securities Exchange Act, will need to determine which of their officers will be subject to the new clawback rules. The company’s board of directors or other supervisory board should approve such determinations.

Companies should also review their current incentive compensation plans and agreements to ensure that any existing clawback or indemnification language is consistent with the new rules (e.g., the rules prohibit indemnification of officers for the loss of erroneously awarded compensation), and add provisions to any new plans and agreements stating that such awards will be subject to the company’s clawback policy. For more information on navigating the SEC’s new clawback rules, please refer to the discussion of the rules in this Latham Client Alert and FAQ and to the below flowchart regarding the implementation of clawback policies.



Clawbacks: A visual aid on the implementation of clawback policies for public companies

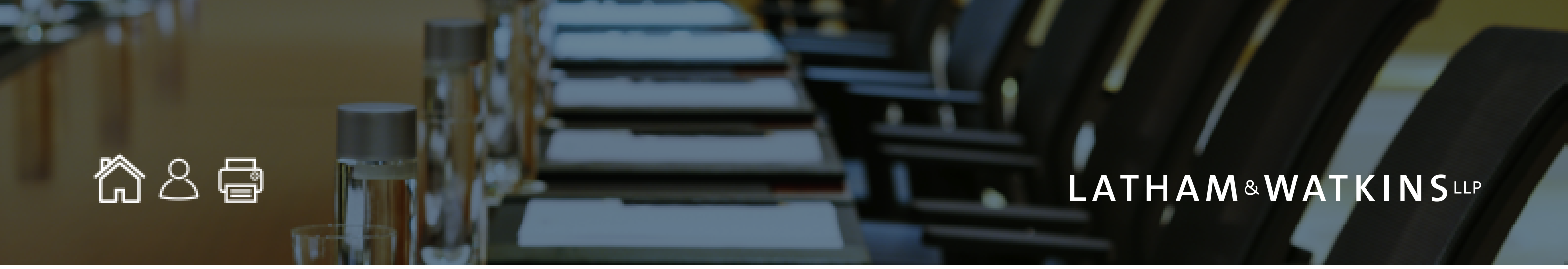


* A "Restatement" means an accounting restatement to correct the company's material noncompliance with any financial reporting requirement under securities laws, including restatements that correct an error in previously issued financial statements (a) that is material to the previously issued financial statements or (b) that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period.

** "Incentive-Based Compensation" is any compensation that was granted, earned or vested based wholly or in part upon the attainment of one of more Financial Reporting Measures. A "Financial Reporting Measure" is any measure determined and presented in accordance with the accounting principles used in preparing the company's financial statements, and any measures derived wholly or in part from such measures, including GAAP, IFRS and non-GAAP/IFRS financial measures, as well as stock or share price and total equityholder return. Awards that are solely earned based on continued service (e.g., time-based equity awards that were not originally awarded based on the achievement of a financal reporting measure) are not based on FMRs.

*** Incentive-based Compensation is "received" in the company's fiscal period during which the financial reporting measure is attained, even if the payment, vesting or grant of the incentive-based compensation occurs after the end of that period.

**** The date on which a company is "required to prepare" an accounting restatement is the earlier to occur of (i) the date the company's board, a board committee or officer(s) (if authorized to take action) concludes or reasonably should have concluded that the company is required to prepare a restatement or (ii) the date a court, regulatory or other legally authorized body directs the company to prepare an accounting restatement.



Proxy Action Item

Companies should ensure that they have adopted a compliant clawback policy and file the policy with their Annual Report on Form 10-K. NYSE-listed companies should ensure that they have submitted an affirmation of compliance. Companies should provide a brief description of their clawback policies in their proxy statement.

Rule 10b5-1 Updates

On December 14, 2022, the SEC adopted final rules regarding Rule 10b5-1 insider trading plans and related annual and quarterly disclosure requirements. The rules impose new conditions that became effective February 27, 2023, on the availability of the Rule 10b5-1 affirmative defense, including minimum “cooling off” periods for directors, officers, and persons other than the company delaying the first trades after a plan is adopted or amended. The amended Rule 10b5-1 also provides that other than the company, only one trading plan is permitted at a time, rather than multiple overlapping plans, subject to a few limited exceptions. The SEC excluded from this one-trading-plan-at-a-time requirement plans that authorize sell-to-cover transactions to satisfy tax withholding obligations incident to the vesting of certain equity awards, such as grants of restricted stock and restricted stock units, provided that such sell-to-cover arrangements authorize the sale of only enough securities necessary to satisfy tax withholding obligations arising exclusively from the vesting of a compensatory award. This exception does not apply to sales incident to the exercise of stock options.

Under the new rules, companies must provide quarterly disclosures for each of their directors and officers regarding any adoption, modification, or termination of Rule 10b5-1 plans or any other written trading arrangements that do not qualify for the Rule 10b5-1 affirmative defense and a description of the material terms of each plan other than pricing terms.

In addition, Forms 4 and 5 now feature a mandatory checkbox to indicate whether a reported transaction occurred under a Rule 10b5-1 plan, and if so, the plan’s adoption date.

For more information on the SEC’s new Rule 10b5-1 plan and disclosure requirements, please refer to the discussion of the rules in this Latham Client Alert.

Proxy Action Item

Companies that currently have sell-to-cover arrangements will want to review their existing arrangements to assess compliance with the new rules and any related disclosure requirements.

Equity Grant Practices Disclosure

New Item 402(x) of Regulation S-K requires narrative and tabular disclosure related to equity awards granted close in time to an issuer’s release of material nonpublic information, or MNPI. The rule is effective for the first SEC filing covering a full fiscal year that begins on or after April 1, 2023 (or, for smaller reporting companies, October 1, 2023). As a result, calendar year-end companies’ actions during 2024 will be subject to the new disclosure requirement for their 2024 annual filings filed in 2025.

Companies must provide narrative disclosure on their policies and practices related to the timing of awards of stock options, SARs, or similar instruments in relation to the disclosure of MNPI, including (i) how the board determines when to grant awards (for example, whether awards are granted on a predetermined schedule); (ii) whether and how the board or compensation committee takes MNPI into account when determining the timing and terms of an award; and (iii) whether the registrant has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.

Additionally, companies must provide tabular disclosure on a grant-by-grant basis of any stock options (and other similar instruments, such as SARs) granted to named executive officers during the last completed fiscal year if made **within four business days prior to or one business day after** the filing of a periodic report (10-K or 10-Q) or the filing or furnishing of a Form 8-K containing MNPI (including earnings releases). Such tabular disclosure must include (i) the name of the named executive officer; (ii) the grant date; (iii) the number of securities underlying the award; (iv) the per-share exercise price; (v) the grant date fair value of the award; and (vi) the percentage change in the market value of the securities underlying the award between one trading day before and one trading day after disclosure of the MNPI.

The new Item 402(x) table is excerpted below:

Name	Grant Date	Number of securities underlying the award	Exercise the price of the award ($/hr)	Grant date fair value of the award	Percentage change in the closing marker price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the training day beginning immediately following the disclosure of material nonpublic information
(a)	(b)	(c)	(d)	(e)	(f)
PEO					
PFO					
A					
B					
C					

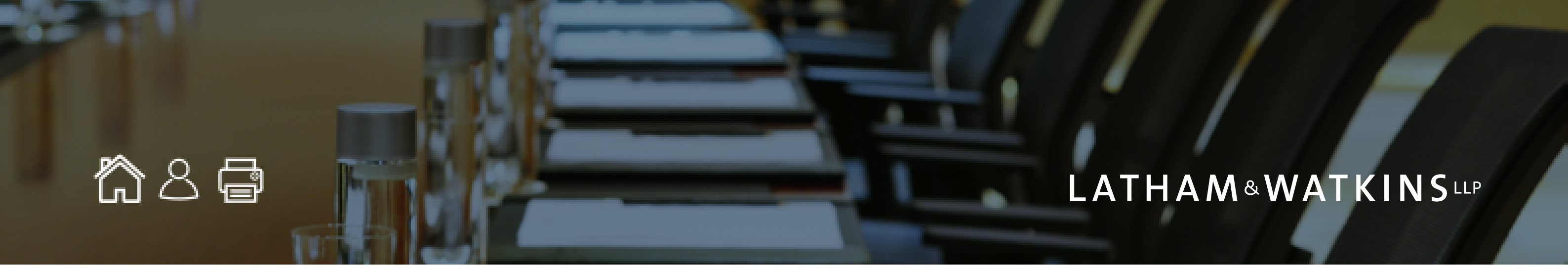
In accordance with the scaled disclosure requirements of Regulation S-K, SRCs and emerging growth companies (EGCs) may limit the disclosures in the table to their named executive officers for the applicable fiscal year, which includes the principal executive officer (PEO), the two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year, and up to two additional individuals who would have been the most highly compensated but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year.

Proxy Action Item

Companies should review their equity grant practices, policies, or guidelines to ensure they align with current practice (while retaining necessary flexibility), including consideration of the impact of the SEC's disclosure requirements. Note that written grant guidelines and policies can potentially protect against actual or perceived option grant timing issues by setting parameters on awards and establishing internal controls. However, failure to follow established policies or guidelines can exacerbate the issue by highlighting poor internal controls.

Companies should also reassess the timing of equity award grants in relation to planned MNPI releases, including:

- Review equity award grant practices in relation to planned releases of MNPI, repurchases, or filings
- Consider avoiding option grants during the period four business days before or one business day after filing a Form 10-K, 10-Q, or 8-K disclosing MNPI
- Consider internal pre-clearance process with respect to any off-cycle grants that are expected to be close in time to the planned release of MNPI

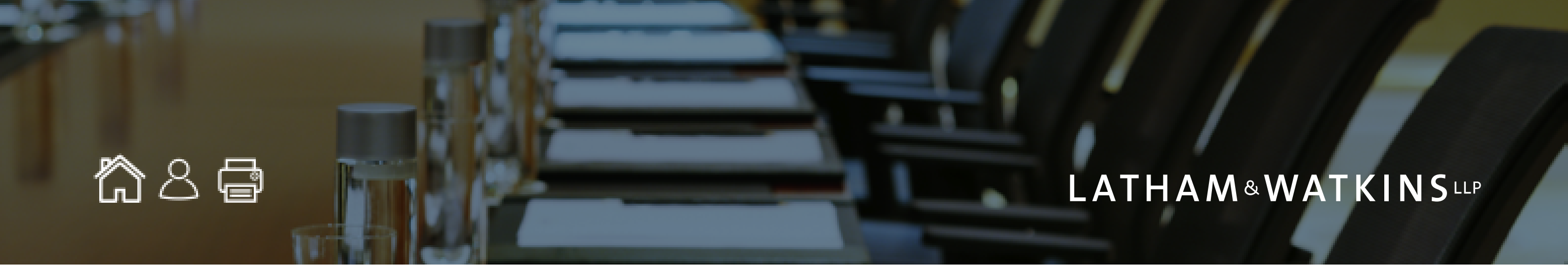


Proxy Advisory Policy Updates

In December 2023, Institutional Shareholder Services (ISS) and Glass Lewis released updates to their 2024 voting policies (along with updates to ISS' compensation and equity plan-related FAQs). The Glass Lewis voting guidelines are effective for all companies with annual meetings on or after January 1, 2024, and the ISS voting guidelines are effective for all companies with annual meetings on or after February 1, 2024. Below is a summary of certain compensation-related policy changes and updates that companies should consider when preparing for the 2024 proxy season.

Key ISS Updates

Executive Severance Agreements	ISS updated its policy to include its case-by-case approach to evaluating shareholder proposals requiring that executive severance arrangements (including change in control-related arrangements) be submitted for shareholder ratification. Factors that ISS considers include, but are not limited to: • Problematic features in the company's existing severance or change in control arrangements (e.g., excessive severance entitlements, single-triggers, and excise tax gross-ups) • Any existing limits on cash severance payouts or policies that require shareholder ratification of severance payments exceeding a certain level • Any recent severance-related controversies • Whether the proposal is overly prescriptive (e.g., requiring shareholder approval of severance that does not exceed market norms)
Changes to Equity Plan Scorecard	As discussed in its US Equity Compensation Plans FAQ, ISS made changes to its Equity Plan Scorecard (EPSC) framework for evaluating equity incentive plan proposals, including: • Decreased weighting of the "Shareholder Value Transfer" (calculated based on the number of new shares requested, plus the number of shares remaining available, plus the number of shares subject to outstanding grants) factor for the S&P 500 and Russell 3000 models • Decreased weighting of the "Grant Practices" pillar for the S&P 500, Russell 3000, and non-Russell 3000 models • Increased weighting of the "Plan Features" pillar for the S&P 500, Russell 3000, and non-Russell 3000 models
Use of Non-GAAP Metrics	In its US Compensation Policies FAQs, ISS stated that if adjustments to non-GAAP metrics materially increase incentive payouts, then companies should provide clear disclosure in the proxy explaining the nature of the adjustment, its impact on payouts (in dollars or a percentage), and the board's rationale for such adjustments. ISS stated that inclusion of line-item reconciliation to GAAP results in the proxy, when possible, is considered best practice.

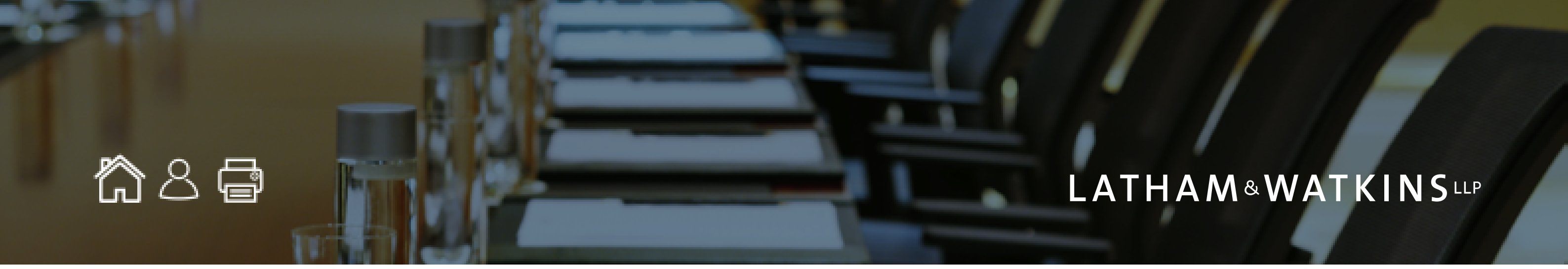


Key Glass Lewis Updates

Clawback Provisions	Glass Lewis updated its benchmark policy guidelines to state that effective clawback policies should, in addition to meeting the applicable listing requirements, authorize the company to recover incentive compensation from an executive if there is evidence of material misconduct, reputational failure, risk management failure, operational failure, or other problematic decisions or actions, if the consequences of such actions have not been reflected in the applicable incentive compensation and where recovery is warranted, regardless of whether the executive was terminated with or without cause. If a company ultimately decides not to recover compensation from the executive under these circumstances, the company should disclose the rationale and any alternative measures that are pursued (e.g., negative discretion on future payments). Glass Lewis did not state what the impact of its policy update will be on say-on-pay proposals if a company has not adopted such a broader clawback policy.
Executive Stock Ownership Guidelines	Glass Lewis updated its benchmark policy guidelines to state that companies should adopt and enforce minimum share ownership rules for their named executive officers, as well as provide CD&A disclosure on such rules and how various equity awards are treated for determining the level of ownership. Unearned performance-based full value awards and unexercised stock options should generally not be counted for purposes of determining stock ownership; companies should provide an explanation if such awards are counted.
Clarifying Amendments	**Non-GAAP to GAAP Reconciliation Disclosure**: Glass Lewis clarified that the absence of reconciliation of non-GAAP results used for incentive payout determinations and reported GAAP results, particularly if significant adjustments were made and materially impacted incentive pay outcomes, may be a factor in their recommendation for the say-on-pay proposal. **Pay Versus Performance Disclosure**: Glass Lewis updated its discussion of its pay-for-performance analysis to note that a company's pay versus performance disclosure, including "compensation actually paid" data, may be used as part of its supplemental quantitative assessments supporting their primary pay-for-performance grade. **Company Responsiveness for Say-on-Pay Opposition**: Glass Lewis confirmed that when calculating the percentage of opposition for a say-on-pay vote, the calculation of opposition includes votes cast as either "against" and/or "abstain."

Proxy Action Item

Companies should consider how ISS' and Glass Lewis' voting policies may affect their proxy proposals and executive compensation disclosure. Enhanced disclosure and additional planning prior to a proxy filing may be appropriate in certain cases to counter a potential adverse recommendation.



Focus on Executive Severance Payments and Terminations

In light of ISS' increased focus on disclosure regarding executive termination arrangements, companies should consider the disclosure relating to executive terminations and corresponding severance payments. ISS' view is that severance is intended for involuntary or constructive job loss and is not appropriate for executives who voluntarily resign or retire. ISS has noted that indicating an executive "stepped down" or that the executive and board "mutually agreed" on a departure does not clearly indicate an involuntary termination. It also noted that paying severance without disclosing a corresponding involuntary termination is a problematic pay practice under ISS policies that will likely trigger an adverse vote recommendation on compensation-related proposals (e.g., say-on-pay). To enable investors to fully evaluate severance payments, a company should disclose both the type of termination (e.g., termination without cause or resignation for good reason) as defined under the agreement and the provision by which severance payments were made under the agreement.

Proxy Action Item
Companies should carefully consider disclosure related to executive departures, especially when they have provided severance payments.

CEO Pay Ratio

Pursuant to the SEC rules requiring companies to disclose their CEO and median-compensated employee pay ratio, a company is only required to identify its median employee once every three years, unless there has been a change to its employee population, employee compensation arrangements, or the median employee's circumstances that the company reasonably believes would result in a significant change to its pay ratio disclosure. Note that the rule does not, however, preclude a company from identifying a new median employee each year, should the company choose to do so. Each public company subject to the CEO pay ratio requirement[1] will need to make an annual determination as to whether its median employee may continue to be used in years two and three. Therefore, a company should take the following key steps in making that annual determination:

Step 1	***Has the company previously disclosed a CEO pay ratio?*** If the answer is yes, move to Step 2. For companies required to disclose their CEO pay ratio for the first time in 2024, please refer to the discussion of the rules governing the calculation of the ratio in this Latham Client Alert. Companies should also note that once the same median employee has been used for three years, the company will need to identify a new median employee in accordance with the SEC rules.
Step 2	***Has there been a significant change in the company's employee population or compensation arrangements that would result in a significant change to the company's pay ratio disclosure?*** If the answer is no, move to Step 3. If the answer is yes, then a new median employee must be identified. The company will need to disclose that it has identified a new median employee and include the required information regarding the assumptions used in that calculation.
Step 3	***Have the median employee's circumstances changed (such as a departure, promotion, or significant change to compensation) in a manner that would result in a significant change to the company's pay ratio disclosure?*** If the answer is no, move to Step 4. If the answer is yes, and using the original median employee is no longer appropriate because there has been a change in the original median employee's circumstances, the company may elect to 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. Alternatively, the company may elect to run a full analysis to identify a new median employee.

Step 4

Has there been no significant change to the company's employee population or compensation arrangements, and have the median employee's circumstances remained the same? If the answers to the questions in Step 2 and Step 3 are no, and if the company will continue to use the same median employee, the company must disclose this information in its CEO pay ratio disclosure and briefly describe that there have been no changes that the company reasonably believes would significantly affect its pay ratio disclosure. As a reminder, the total annual compensation of the median employee must still be recalculated for the previous fiscal year, and the CEO pay ratio must be recalculated based on the CEO's previous fiscal year compensation.

In preparing for their 2024 proxy statements, companies may consider including supplemental disclosures that they believe will provide helpful context to investors, such as adding language to contextualize the pay of rank-and-file employees and more broadly discussing human capital practices. However, supplemental CEO pay ratios are still relatively uncommon.

Proxy Action Item

Although most companies will not need to identify a new median employee for purposes of their CEO pay ratio disclosure every year, all companies will need to determine annually whether a new median employee should be identified and include the appropriate required disclosure based on their circumstances.

In addition, companies with two principal executive officers during the prior fiscal year will need to determine how they want to calculate the CEO's compensation for purposes of the pay ratio disclosure based on one of the SEC's permitted methods, which are described in detail in this Latham Client Alert.[2]

Equity Plan Matters

While some companies are already planning to include equity plan proposals in their annual meeting agendas during 2024 — whether to adopt new plans, obtain additional shares, or for other reasons — all companies should consider reviewing the following items annually with respect to their equity plans:

- **Plan Expiration Dates.** Companies should review existing equity plans to determine whether the plans are subject to expiration in 2024, and whether they should take action at the 2024 annual meeting to extend the plan or adopt a new plan prior to such expiration. Best practice is to seek approval of a new plan or plan extension in the year prior to the year of expiration, if possible.

- **Share Reserves.** Companies should review existing equity plans to determine whether additional shares will be needed, and, if so, when. Companies can then strategically plan the best approach to seek stockholder approval of additional shares.

- **Other Plan Limitations.** Companies should review individual award limits and determine whether they are still able to administer equity compensation programs within such individual award limits. Companies should also review compliance with minimum vesting provisions.

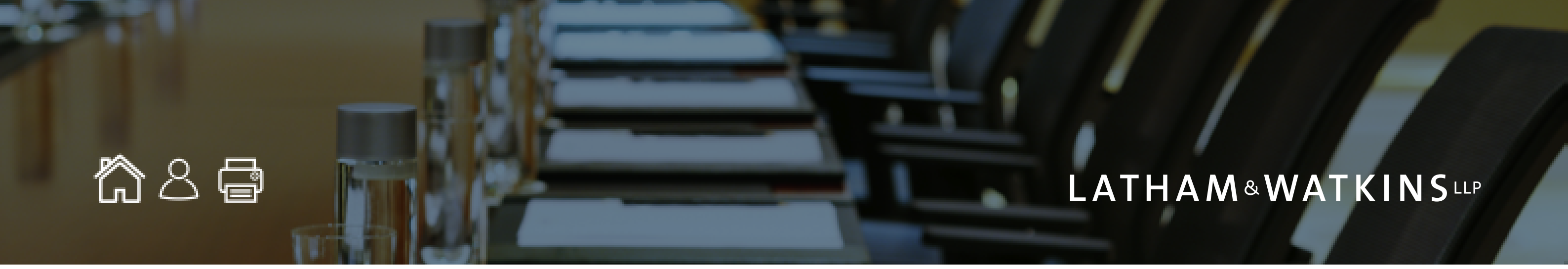
- **Form 10-K Disclosure.** Companies should review annually the footnote disclosure in their Annual Report on Form 10-K regarding equity plans for accuracy and consistency with plan documents. This can be especially important in a year in which an equity plan proposal is on the calendar, as ISS may default to a company's Form 10-K disclosure in its evaluation if all necessary information is not included in the proposal. If a company grants performance awards, they should ensure that burn rate information is included in the Form 10-K as suggested per ISS policies so that ISS will consider performance awards accurately in its burn rate analysis.

Companies that are already planning to include equity plan proposals in their annual meeting agendas during 2024 to adopt new plans, obtain additional shares, or for other reasons will also want to consider the following items when crafting new or amended equity plans and related proposals, in addition to considering the proxy advisory firm voting policies on equity plan proposals:

- **Adoption of a New Plan or Restatement of an Existing Plan.** Companies that have identified a need to seek stockholder approval for additional shares or other reasons will want to consider whether to restate an existing plan or, potentially, adopt a new plan. Adopting a new plan may present certain advantages, especially with respect to application of proxy advisory firm policies regarding certain changes that may be viewed as adverse to stockholders if implemented through a restatement (e.g., removal of individual award limits). However, adopting a new plan may necessitate the drafting of new award agreements and changes to existing administrative systems. If a company decides to adopt an amendment to an existing plan (as opposed to a restatement), it will want to include either a specific cross-reference to the public filing of the existing plan or the existing plan itself in the proxy, as ISS may recommend against a plan amendment. Notably, ISS views a summary of the plan alone as insufficient to enable investors to make an informed evaluation of the full equity plan, as proposed to be amended.
- **Director Compensation Provisions.** Companies may wish to include specific dollar-denominated director compensation limits or formula director awards in their equity plans, or even adopt a separate formulaic, stockholder-approved director plan, to address increased risk of legal attacks on director compensation in their equity plans. Companies should also carefully review any disclosure in their equity plan proposals related to potential awards to directors.
- **Clawbacks.** In order to allow companies to claw back compensation under a clawback policy in effect pursuant to the Dodd-Frank final clawback rules, as discussed above, or pursuant to misconduct under other clawback policies that might be adopted in the future, companies that have not already done so should consider obtaining acknowledgments to the clawback policy from covered executives and add provisions in their incentive compensation plans and agreements providing that all awards made thereunder are subject to such clawback policy(ies).

Proxy Action Item

Companies should carefully evaluate a number of plan provisions and drafting considerations if an equity plan proposal is on their annual meeting agenda.



Reporting Status

EGCs Should Confirm Continuing EGC Status or Date of Loss of Status

Companies that previously qualified as an EGC should review whether they will remain in EGC status for 2024. EGCs are given a temporary transition period during which they are required to comply with scaled disclosure requirements. A company will remain an EGC until the earliest of:

- the last day of any fiscal year in which the company earns $1.235 billion or more in revenue;
- the date when the company qualifies as a “large accelerated filer,” with at least $700 million in public equity float;
- the last day of the fiscal year ending after the fifth anniversary of the IPO pricing date; or
- the date of issuance, in any three-year period, of more than $1.0 billion in non-convertible debt securities.

EGC status will ordinarily terminate on the last day of a fiscal year.[3]

Potential New Requirements if Exiting EGC Status

An EGC generally must hold a say-on-pay vote no later than one year after it ceases to qualify as an EGC. However, if a company has been an EGC for less than two years after its IPO, the company has up to three years after the IPO to hold the vote — though a say-when-on-pay vote may need to occur earlier. For EGCs, the say-when-on-pay vote is required as early as the first annual meeting after the company ceases to be an EGC, regardless of when the company ceased being an EGC following its IPO.

Generally, companies that lose EGC status (and do not qualify as an SRC) will also need to revise the compensation disclosure in their proxy statements to incorporate a full compensation disclosure and analysis (as opposed to complying with the reduced compensation disclosure requirements that apply to EGCs). As discussed above, EGCs are required to include CEO pay ratio disclosure related to compensation during the first year after exiting EGC status. For example, if a company ceases to be an EGC on December 31, 2023, it will be required to include CEO pay ratio disclosure in its proxy statement filed in 2025 that includes 2024 compensation disclosure. Additionally, a company that loses EGC status will also need to include the new pay versus performance disclosure in its first proxy statement after it ceases to qualify as an EGC.

Proxy Action Item

Companies that are or have been EGCs should reconfirm their current status and potential exit date to ensure timely compliance with rules that apply once EGC status is lost. In addition, companies should reconfirm whether SRC status may be available following a loss of EGC status.

Consider Applicability of Smaller Reporting Company Thresholds

SRCs are eligible for a number of "scaled disclosure" accommodations under Regulations S-K and S-X, including reduced executive compensation disclosure.[4]

However, Glass Lewis may consider a negative recommendation for compensation committee members if it believes the reduced executive compensation disclosure could substantially impact stockholders' ability to assess executive pay practices. Separately, ISS will continue to require disclosure that provides stockholders with sufficient information to make an informed say-on-pay vote and otherwise evaluate the compensation program.

Proxy Action Item

Companies that qualify as an SRC may wish to consider the advantages of SRC status, including scaled executive compensation disclosure. Companies should consult with corporate counsel on this decision.

Other Proxy Season Housekeeping and Reminders

2023 Say-on-Pay Vote Response

As always, public companies that conducted a say-on-pay vote in 2023 should consider the results and determine what, if any, changes they should make to executive compensation programs and disclosure. Many companies, particularly those that did not receive strong stockholder support on the say-on-pay proposal, have likely been engaging with stockholders and reviewing their compensation programs. ISS recommends full disclosure of the company's response to a say-on-pay vote of less than 70%, including disclosure related to stockholder outreach, stockholder concerns, and meaningful company actions taken to address stockholder concerns. Glass Lewis considers a negative recommendation for the current proxy's say-on-pay proposal if the company's response to a say-on-pay vote of less than 80% does not include "robust" disclosure of the company's response. Pursuant to SEC rules, all companies must discuss their response to the previous say-on-pay vote in the CD&A. However, companies with low stockholder support on a prior say-on-pay vote should consider more fulsome or "robust" disclosure of stockholder outreach and communication efforts — describing what they heard from stockholders, how they responded, and why — since ISS and Glass Lewis will be specifically looking for this information and gauging the strength of these efforts as they formulate their 2024 voting recommendations.

Proxy Action Item

Companies should disclose their stockholder outreach and response to the 2023 say-on-pay vote. Companies that received weak support in their most recent say-on-pay vote should pay close attention to their disclosure regarding their stockholder outreach and communication efforts, and any compensation-related actions taken in response to those investor discussions.

Say-on-Pay and Say-When-on-Pay Votes

Under Dodd-Frank, public companies generally are required to hold a non-binding, advisory say-when-on-pay vote at least every six years, requesting stockholder advice as to whether say-on-pay votes should be held annually, biennially, or triennially. Accordingly, companies that last submitted say-when-on-pay votes to their stockholders in 2018 will need to do so again in 2024. Companies will want to review and confirm whether a say-on-pay or say-when-on-pay proposal is required in this year's proxy. Glass Lewis will recommend voting against all members of a compensation committee if the board of directors adopts a say-on-pay frequency other than the frequency approved by a plurality of the company's stockholders at the annual meeting. ISS views the board's selection of a say-on-pay frequency that is less frequent than that supported by stockholders in the say-on-pay frequency vote as a problematic practice and may recommend against compensation committee members or the full board of directors. New issuers are required to include the say-on-pay and say-when-on-pay frequency votes in the proxy statement for their first annual meeting after an IPO (unless they qualify as an EGC).

Proxy Action Item

Companies should confirm whether a say-on-pay or say-when-on-pay proposal (or both) are required in 2024. If a say-on-pay vote is required, companies should consult with outside advisers regarding the likelihood of adverse recommendations by proxy advisory firms.

Compensation Adviser Independence

Since 2013, under Dodd-Frank, compensation committees must consider the six independence factors set forth in the New York Stock Exchange's and Nasdaq's listing standards prior to selecting or receiving advice from any compensation consultant, legal counsel, or other adviser who advises the compensation committee.

Proxy Action Item

Companies should ensure that a compensation adviser independence analysis is undertaken prior to retaining new compensation advisers. Best practice is to perform such analysis on an annual basis.

Compensation Risk Assessment

Compensation committees should annually review:

- Management's evaluation of the company's compensation policies and practices
- Management's assessment of whether the policies and practices encourage risk-taking that is reasonably likely to have a material adverse effect on the company
- The company's proxy disclosure regarding such "pay risk"

In the current environment, management and committees undertaking these pay-risk assessments and reviews should keep in mind that pay plans for rank-and-file employees and senior employees need to be reviewed, and that risks to a company's reputation can have a material adverse effect.

Proxy Action Item

Companies should ensure that a compensation risk assessment is undertaken on an annual basis and review SEC disclosures, if any.

Compensation Committee Charter and Compliance

Companies should review the qualifications of their compensation committee members under stock exchange and securities law requirements and reconfirm that their committee membership complies with the requirements under their compensation committee charter. Additionally, companies should reconfirm that their proxy disclosure on such points is still accurate.

Companies should also review the duties enumerated in the compensation committee charter to ensure the terms of the charter line up with the committee's actual calendar and responsibilities. Proxy disclosure should be carefully reviewed to ensure it accurately describes the terms of the charter and the compensation committee's activities in setting executive compensation.

Proxy Action Item

Companies should review their compensation committee charter and proxy disclosure to confirm that they appropriately reflect committee membership, the terms of the charter, and the compensation committee's activities.

Hedging Practices and Policies

US public companies must disclose their hedging practices or policies in their annual proxies or information statements. Foreign private issuers are exempt from this requirement.

A public company is required to describe "any practices or policies it has adopted regarding the ability of its directors, officers and employees to purchase securities or other financial instruments, or otherwise engage in transactions, that hedge or offset, or are designed to hedge or offset, any decrease in the market value of equity securities granted as compensation, or held directly or indirectly by the employee or director." This requirement extends to policies relating to equity securities of the company, any parent company, and any subsidiary of the company or the parent company, and to equity securities whether granted as compensation or otherwise held by such persons. Alternatively, a company can provide the full text of its hedging policy.

If a company does not have any hedging practices or policies, the rule generally requires disclosure of the absence of such practices or policies or a statement that hedging transactions are generally permitted.

As a reminder, ISS will recommend against members of a board committee that oversees risks related to pledging, or against the full board, if ISS determines that a significant level of pledged company stock by executives or directors raises concerns. ISS will consider factors such as a disclosed anti-pledging policy, the magnitude of the pledged stock, disclosure that ownership or holding requirements do not include pledged stock, and progress toward reducing the magnitude of pledging over time. Glass Lewis also disfavors hedging and prefers to see anti-hedging policies.

We recommend that companies include the mandated hedging disclosure in the Corporate Governance section of the proxy or information statement and include a more tailored disclosure in the CD&A to satisfy the CD&A disclosure requirement with respect to its named executive officers.

Endnotes

1 The CEO pay ratio rules apply to all issuers other than EGCs, SRCs, foreign private issuers, Multijurisdictional Disclosure System filers, and registered investment companies. Companies exiting EGC and/or SRC status have the benefit of a one-year transition period.

2 The SEC permits a company to calculate CEO pay when there are two CEOs in one year in one of two ways. The company may either (i) calculate each CEO's compensation during the time period of the relevant year and combine the amounts, or (ii) determine the CEO serving on the date of selection of its median employee and annualize this amount. The method used must be disclosed.

3 However, the issuance in any three-year period of more than $1 billion in non-convertible debt securities would cause an issuer to lose its EGC status immediately. Note, however, that EGC status will be extended during the registration process, even if the registrant's revenues exceed $1.235 billion or the registrant issues in excess of $1 billion of debt securities during the registration process. Any confidential submission or public filing by an EGC will lock in EGC status through the earlier of (i) the IPO date or (ii) one year after the issuer would have otherwise lost EGC status.

4 A company will qualify as an SRC if its public float is below $250 million. In addition, companies with annual revenues of less than $100 million will also qualify as an SRC if they have no public float or a public float of less than $700 million. For more information, see this Latham Client Alert.

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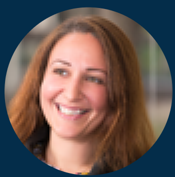

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