February 2022

Companies Can Improve Proxy Disclosure and Shareholder Engagement by Focusing on These Four Topics

From human capital management to climate, we outline four key topics companies should prioritize as they prepare proxy disclosures and engagement with stakeholders for the 2022 proxy season.

In 2021, the United States Securities and Exchange Commission (SEC), Institutional Shareholder Services (ISS) and Glass Lewis adopted policy updates reflecting an increased focus on human capital management (HCM), boardroom diversity and executive pay-related issues. Climate-related disclosures are a growing priority of the SEC's agenda as well. As companies prepare for this proxy season, these topics should be kept front of mind.

What to expect in the second year of required human capital management disclosures

Starting in 2021, the SEC began requiring disclosure in companies' 10-K reports of how they manage their human capital. You can read our analysis of 10-K reports filed in the first half of 2021 after the new SEC rule went into effect. Hot topics included pandemic-related safety measures, diversity and inclusion, compensation and benefits, and talent development.

As companies prepare to disclose their HCM information once again, recent market trends and the trajectory of HCM reporting should be kept in mind. Events like the ongoing pandemic, global supply chain issues and inflation impact a company's ability to manage its human capital and balance external interest from stakeholders. As the pandemic becomes more endemic, companies are streamlining COVID-19 and mental health disclosure into "Employee Health and Safety." In 2022, this category will be positioned as a broad area of disclosure in the 10-K and inclusive of COVID-19 policies and mental and physical welfare.

Recent statements from SEC chair Gary Gensler (see here and here) suggest that the agency is considering switching its HCM disclosure rule from a principles-based approach to a metrics-based approach. This could mean companies will be required to report more concrete data not only on disclosure around governance, strategy, and management related to climate risk, but also human capital and could include metrics such as workforce turnover, skills and development training, compensation, benefits and demographics including diversity, and health and safety.

Diversity and inclusion remains a hot topic

Companies face immense pressure to disclose information regarding board diversity and a company's strategy for achieving it in order to meet evolving investor expectations. Diversity, equity and inclusion (DE&I) is also intertwined with talent engagement, recruitment and retention reporting in the 10-K as companies move towards detailed DE&I workforce metrics and disclosures.

In addition to the points below, companies will need to update their Director and Officer Questionnaires for D&O insurance in order to capture the information required to be disclosed.

- **SEC approves Nasdaq board diversity rules.** In August 2021, the SEC approved a proposal from Nasdaq for new board diversity rules. Rules require Nasdaq-listed companies to have at least one female director and underrepresented minority or LGBTQ+ director, but there are alternative requirements applicable to foreign private issuers and smaller reporting companies. See our initial article on the impact to companies.
- **ISS and Glass Lewis prioritize gender diversity.** ISS currently recommends voting against or withholding from the chair of the nominating committee or other directors on a case-by-case basis at Russell 3000 and S&P 1500 companies where there are no female directors on the board. The updated coverage broadens the requirement to all companies listed in the U.S. regardless of index status. See our 2022 ISS voting policy updates article for more detail.

  In 2023, ISS will expand the coverage of its 2019 board gender diversity policies to include all companies listed in the U.S. Also, Glass Lewis plans to transition next year from a fixed numerical approach to a percentage-based approach and will generally recommend voting against the nominating and governance committee chair of a board that is not at least 30 percent gender diverse at Russell 3000 companies.
- **Glass Lewis changes voting standards.** The proxy advisor's annual update to its policy voting recommendations covers topics such as board diversity, board oversight of risks and corporate governance practices. See our 2022 Glass Lewis voting policy updates article for more detail.

  Glass Lewis will consider recommending investors vote against the chair of the nominating and governance committee at S&P 500 companies with poor disclosure, which it defines as not providing any disclosure in each of the following categories:

  - the board's current percentage of racial/ethnic diversity;
  - whether the board's definition of diversity explicitly includes gender and/or race/ethnicity;
  - whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (i.e., the "Rooney Rule");
  - and board skills disclosure.

Climate disclosures are quickly evolving

The SEC is poised to propose a new climate change disclosure rule in the first six months of 2022. In July 2021, the SEC received more than 550 comment letters in response to the commission's statement on climate disclosures months prior.[1]

As SEC rulemaking on the topic is pending, companies should evaluate their climate-related disclosure based on existing SEC guidance. Companies should also look to new ISS and Glass Lewis voting policies as they consider disclosure of climate-related risks. ISS formally adopted an approach for

[1] "Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar," Chair Gary Gensler, U.S. Securities and Exchange Commission, July 28, 2021, https://www.sec.gov/news/speech/gensler-pri-2021-07-28.

analyzing say-on-climate (SoC) management and shareholder proposals, which ask for climate transition and reporting plans.

ISS has expanded its approach of climate-related issues by introducing a board accountability policy for the assessment of and focus on companies considered to be the world's highest greenhouse gas emitting companies. Meanwhile, Glass Lewis clarified its approach to management proposals asking shareholders to approve say on climate, as well as shareholder proposals asking companies to adopt such a vote. The firm will generally oppose shareholder proposals requesting that companies adopt a say-on-climate vote, a new type of proposal that emerged in the 2021 proxy season.

Staying on top of executive compensation changes

In December 2021, ISS posted several updated FAQs for pandemic-related pay adjustments. Learn more about the updates in our original article. Key highlights include:

- **ISS issues new equity burn rate changes.** ISS currently calculates burn rate benchmarks for specific industry groupings in three index categories: S&P 500, Russell 3000 (excluding S&P 500) and non–Russell 3000. We recommend that companies review their 10-K stock plan footnote disclosures and proxy proposal disclosures to ensure they maximize their ISS burn rate profiles with adequate granting information. We also recommend that companies evaluate annual equity usage by utilizing a few different burn rate methodologies as part of the annual benchmarking process. See our original article for more information.
- **SEC proposes new narrative disclosure of option grant policies.** This disclosure is intended to provide shareholders with a full and complete picture of any so-called "spring-loaded" or "bullet-dodging" stock option grants made during the fiscal year (see our recent article on spring-loaded stock awards). These disclosures would also apply to smaller reporting companies and emerging growth companies, which are generally subject to less extensive executive compensation disclosure requirements than other reporting companies.
- **SEC reopens pay versus performance comment period.** New developments prompted the reopening for new comments and data on rule amendments and changes from the 2015 proposal that the SEC is considering. The comment period to respond will be open until March 2, 2022.

Next Steps

Deadlines to finalize 10-K disclosures are rapidly approaching. The policy updates covered above contain numerous provisions that will impact boards of directors and executives. Companies should balance priorities and viewpoints from a variety of stakeholders, including investors, customers, employees, regulatory agencies and more as they think through their proxy disclosures and upcoming engagement plans.

Stakeholders are requiring increased transparency from public companies about how they are managing their workforce and environmental risks. Every company approaches disclosure differently, and companies that are direct and transparent about the four topics covered above will be better positioned to confront the upcoming proxy season and emerging risks.

Our global team of experts have legal, investor and proxy advisor expertise to help you prioritize the right considerations for the upcoming proxy season and beyond. For questions about these topics and to speak with one of our experts, please write to humancapital@aon.com.

Author Contact Information

Laura Wanlass
Partner, Human Capital Solutions
Aon
+847.771.6263
laura.wanlass@aon.com

Rachel Cohen
Senior Consultant, Human Capital Solutions
Aon
+614.307.9279
rachel.d.cohen@aon.com

Jim Kroll
Partner, Human Capital Solutions
Aon
+760.408.6008
jim.kroll@aon.com

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