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TEN HOT TOPICS & ONE REMINDER:

DEVELOPMENTS IN GOVERNANCE AND DISCLOSURE

FALL 2017

1 PAY RATIO IMPLEMENTATION: UPDATE FOR THE BOARD AND COMPENSATION COMMITTEE.

The 2018 proxy season will be the first time many companies[1] are required to comply with the SEC's pay ratio rule, which was adopted by the Commission in 2015 pursuant to the Dodd-Frank Act. The pay ratio rule requires companies to disclose (i) the annual total compensation of the median employee, (ii) the annual total compensation of the CEO and (iii) the ratio of those two amounts. The rule is draconian and highly detailed, and involves the interplay between the over 300 pages released by the SEC on the rule and the traditional Item 402 and Form 8-K rules.

Earlier this year, many hoped that either Congress or the SEC would act to either repeal or delay implementation, but it is now clear that most companies will have to comply with the rule in their 2018 disclosure. In addition to the final rule the SEC issued in 2015, the Division of Corporation Finance issued guidance on the rule in October 2016 and September 2017. Several of the compliance and disclosure interpretations issued by the Division substantively change the scope of the rule, therefore a thorough knowledge of both the final rule and the Division's guidance is critical for implementation.

In considering implementation, companies should begin by assessing their employee population and payroll systems. Each company will then need to determine its approach for evaluating its employee population's pay, which will include picking a pay measurement methodology or methodologies. For many companies, completing these initial tasks will represent the majority of the work involved in implementing the rule. Depending on the complexity of a company's employee population (e.g., number of jurisdictions, payroll systems), it may take a company several months to obtain the relevant data.

Note on Other Dodd-Frank Executive Compensation Provisions. In mid-July 2017, the SEC issued an updated Agency Rule List which removed several executive compensation-related proposed rules from the "proposed rule state" list to the "long-term actions" list. The items moved to the "long-term actions" list include the pay-for-performance, clawbacks, and hedging proposed rules. The SEC also moved universal proxy to the "long-term actions" list.

[1] Applicable to all registrants required to provide disclosure under Item 402 of Regulation S-K; therefore, the only companies specifically carved out are smaller reporting companies, foreign private issuers and MJDS filers; in addition, emerging growth companies were specifically carved out by the JOBS Act. Transition periods are provided for companies that cease to be smaller reporting companies or emerging growth companies.

2 PROXY ACCESS: UPDATE FOR THE BOARD AND NOMINATING/ GOVERNANCE COMMITTEE.

Since the New York City Comptroller's 2015 efforts to push companies to adopt proxy access, more than 425 companies, including 60% of companies in the S&P 500 index, have adopted provisions. Throughout the 2017 proxy season, stockholder support of Rule 14a-8 proxy access proposals remained strong, with nearly all receiving majority support. In contrast, all of the stockholder proposals seeking to amend previously adopted proxy access provisions failed to achieve majority support. Given the continued interest of investors and investor-related groups, corporate governance specialists expect large-cap companies to continue to adopt proxy access provisions, with slower, but steady, rates of adoption among mid- and small-cap companies. To date, there has been only one attempt by an investor to use proxy access in the U.S., and it remains unclear whether and how proxy access will be utilized by investors.

3 PCAOB AUDITOR REPORT REQUIREMENTS: UPDATE FOR THE AUDIT COMMITTEE.

On June 1, 2017, the PCAOB adopted new requirements for auditor reports that would significantly modify the auditor's reporting model. On October 23, 2017, the SEC approved the PCAOB's proposed Auditing Standard 3101. The new rules will require auditors to include new disclosures in their reports regarding "critical audit matters."[2] "Critical audit matters,"or "CAMs," a new concept in audit reporting, is defined as "any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment." It is not currently clear to what degree this new concept will influence other aspects of the audit process, such as the relationships between the audit committee, internal audit, auditors and management. The PCAOB's new requirements also include disclosures regarding the auditor's tenure and independence.

[2] The PCAOB's standard specifies that CAMs do not have to be disclosed in audit reports issued in connection with audits of emerging growth companies, brokers and dealers, investment companies other than business development companies, or employee stock purchase, savings and similar plans.

4 NEW ACCOUNTING STANDARDS DISCLOSURE: UPDATE FOR THE AUDIT COMMITTEE.

In May 2014 the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, *Revenue from Contracts with Customers.* Since then, several additional ASUs have been issued to clarify various elements of the guidance and to extend the date of implementation. Now adoption is around the corner—adoption is effective for reporting periods beginning after December 15, 2017 for calendar-year companies, and early implementation is permitted. SEC staff has urged companies to raise questions regarding implementation sooner rather than later, and has indicated that it expects implementation to have a material impact on most companies' disclosures. In addition to a company's disclosure, implementation is likely to require changes in a company's internal control procedures. Implementation may also have unexpected consequences, for example, companies planning to file a new Form S-3 or a post-effective amendment to a Form S-3 may want to consider doing so prior to implementation to avoid having to revise 2015 financial statements as well (although this requirement would not apply in every instance). Many companies are also in the process of assessing the impact of or implementing other ASUs, including ASUs regarding measuring inventory, the presentation of tax assets and liabilities, accounting for share-based payment transactions, and recognition of certain assets and liabilities related to leases.

5 UPDATE ON ENVIRONMENTAL AND SUSTAINABILITY MATTERS: UPDATE FOR THE BOARD AND OTHER RELEVANT COMMITTEES.

On August 31, 2017, Vanguard released its annual ***Investment Stewardship Report***, which greatly expanded on prior years' reports, along with **an open letter** to directors of public companies from Chairman and CEO Bill McNabb. In its Report, Vanguard expressed concern regarding the "absence of clear disclosure and informed board oversight" over climate change risk, and indicated that it will be paying closer attention to corporate disclosures on climate change risk and stockholder proposals requesting greater disclosure. On August 14, 2017, State Street Global Advisors issued new climate change disclosure guidance targeting U.S. and international public companies primarily in the oil and gas, utilities and mining sectors. The new guidance, entitled ***Perspectives on Effective Climate Change Disclosure***, identifies "best practices" in climate-related disclosure (primarily referencing European companies) and prescribes detailed disclosure methods in areas it deems pertinent to investors. This guidance follows State Street's ***Global Proxy Voting and Engagement Principles***, published in March 2016 and its **January 2017 letter to corporate directors**, both of which made clear that State Street was engaging directly with companies on enhancing environmental disclosures. In June 2017, the

Task Force on Climate-related Disclosures, sponsored by the Group of 20, which has called for new disclosures by companies in all sectors, similarly urged companies to assess the viability of their short- and long-term business models in relation to hypothetical, near-future scenarios in which demand for carbon assets is significantly lower and the price of carbon assets has changed significantly.

Despite the early June 2017 announcement of the President's decision to withdraw the U.S. from the Paris climate agreement, a number of U.S. cities, states and companies have launched various efforts and expressed commitments to pursue the goals of the Paris agreement. In anticipation of President Trump's announcement, on May 10, 2017, the CEOs of 30 large U.S. companies **publicly reinforced their commitment** to continuing their climate change mitigation efforts. Days after President Trump announced that the U.S. would be withdrawing from the global climate agreement, more than 1,200 business leaders, mayors, governors and college presidents promised in **an open letter** to "continue to support climate action to meet the Paris Agreement." During the 2017 proxy season, approximately 33 companies received stockholder proposals requesting that they report on and/or assess the impact of meeting the "2 degree scenario," which under the Paris agreement is the upper limit on global warming that could avert the worst consequences of climate change. In contrast, only approximately 26 such proposals were received by companies during the 2016 proxy season, despite the overall decrease in the aggregate number of stockholder proposals from 2016 to 2017. Given recent developments, we expect the 2 degree scenario to be of particular focus during the upcoming 2018 proxy season.

6 BOARD DIVERSITY: UPDATE FOR THE BOARD AND NOMINATING/GOVERNANCE COMMITTEE.

Board diversity has been a matter of increasing interest among investors and investor-related groups in the U.S. While various European countries have either required or recommended gender quotas for boards of directors over the past few years, there has been less appetite in the U.S. for limitations in this area. Recently, however, a number of influential players in the U.S. investment world have made statements regarding the importance of board diversity, signaling that boardroom diversity may become a more serious issue for more investors when they evaluate company performance and cast their votes at annual meetings. For the 2017 proxy season, State Street voted against the re-election of directors at 400 companies — over 10% of all U.S. public companies — for failure to take steps to add women to their boards in adherence with State Street's board diversity initiative. In its March 2017 top engagement priorities, BlackRock indicated that it plans to look at how companies are working to increase boardroom diversity in assessing company performance/responsiveness. Vanguard's Investment Stewardship Report, in addition to discussing Vanguard's views on climate change-related disclosures and proposals, also focuses on gender diversity on boards and indicates that Vanguard will consider whether companies are making meaningful progress in this area in its future voting decisions. ISS's August 2017 survey for 2018 policy updates asked whether the absence of female directors on a public company's board is problematic and, if so, what factors have an effect on that analysis. Although ISS's proposed 2018 U.S.

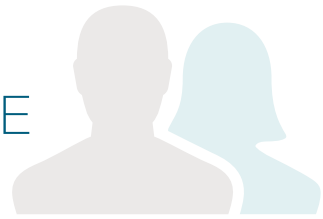
policy changes, issued on October 26, 2017, do not contain a policy regarding boardroom diversity, they do contain a proposed policy regarding gender pay gap proposals, and ISS's proposed 2018 Canada policy changes do contain a proposed policy on boardroom diversity. We expect that ISS may still be considering whether to adopt a similar policy in the U.S. in the future.

On September 8, 2017, New York City Comptroller Scott M. Stringer and the New York City Pension Funds **announced** the launch of the "Boardroom Accountability Project 2.0." According to the press release, this next phase of the Comptroller's campaign "will ratchet up the pressure on some of the biggest companies in the world to make their boards more diverse, independent, and climate-competent." The release focuses on board diversity, and states that the Comptroller has sent letters to the boards of 151 companies "calling on them to publicly disclose the skills, race and gender of board members and to discuss their process for adding and replacing board members."

Throughout 2017, CalPERS has been submitting letters to companies regarding board diversity. The form CalPERS letter notes that the company's board lacks gender diversity, and encourages the company to develop and disclose the company's policy for considering board diversity and an implementation plan in its proxy statement and related governance documents. This latest campaign is similar to a series of letters relating to board diversity that CalPERS submitted to over 100 companies in 2014. Following that campaign, many of the companies that had received letters received Rule 14a-8 stockholder proposals regarding board diversity for their 2015 annual meetings. Stockholder proposals addressing board and management-level diversity matters rose sharply during the 2017 proxy season, and we expect this upward trend to continue in the 2018 proxy season.

7 UNILATERAL BOARD ACTION AND LIMITED VOTING RIGHTS: UPDATE FOR THE BOARD.

ISS's proxy voting policy changes for 2015 and 2016 garnered a fair amount of attention when it introduced and then revised a new stand-alone policy providing that ISS would generally issue negative recommendations against directors where a board amends the company's bylaws or charter without stockholder approval in a manner that "materially diminishes" stockholder rights or that could adversely influence stockholder rights. While newly public companies previously faced less scrutiny from ISS, the unilateral board action policy signaled a shift in ISS's approach, with IPO companies coming under increasing pressure to comply with the same standards. Following the Snap, Inc. IPO, the first to issue only non-voting shares to the public, and increasing investor criticism of dual class stock structures that concentrate voting control in the hands of founders and early-round investors, ISS's August 2017 survey for 2018 policy updates asks when it is appropriate, if ever, for companies to issue multi-class capital structures with unequal voting rights and whether those structures should automatically expire or be subject to periodic reapproval by holders of the low-vote shares. These moves may signal a desire on the part of some investors and investor-related groups to hold newly public companies and smaller companies to the same standards to which larger, more mature organizations are held.



8 INLINE XBRL: UPDATE FOR THE BOARD.

On March 1, 2017, the SEC proposed rules to require the use of the Inline eXtensible Business Reporting Language ("XBRL") format for the submission of operating company financial statement information and certain mutual fund information.[3] Inline XBRL allows XBRL data to be embedded directly into an HTML document. With Inline XBRL, filers need to tag the required disclosures using the applicable taxonomy, and the tagging would be performed within the HTML document instead of a separate XBRL exhibit. The proposed amendments would also eliminate the requirement for filers to post Interactive Data Files on their websites.

9 VIRTUAL MEETINGS: UPDATE FOR THE BOARD AND NOMINATING/GOVERNANCE COMMITTEE.

In recent years, an increasing number of companies have opted to hold annual stockholder meetings exclusively online, rather than only holding a physical meeting, or holding a physical meeting and permitting online participation (a.k.a. a "hybrid meeting"). Although virtual meetings are still a small minority of total annual stockholder meetings, the number of companies holding virtual meetings has been steadily rising over the last few years. Virtual meetings can benefit both stockholders and companies; however, some investors remain resistant, and virtual meetings became a topic of Rule 14a-8 stockholder proposals in the most recent proxy season.

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[3] The proposed Inline XBRL requirements for financial statement information would apply to all operating company filers, including smaller reporting companies, emerging growth companies, and foreign private issuers that are currently required to submit financial statement information in XBRL. The proposed Inline XBRL requirements would be phased in based on the category of filer.

10

PROXY STATEMENT REDESIGN ("PROXY REFRESH"): UPDATE FOR THE BOARD, NOMINATING/GOVERNANCE COMMITTEE AND COMPENSATION COMMITTEE.

Over the past two proxy seasons, companies have increasingly sought to turn their proxy statements into sales documents. This approach discusses company performance and provides information in a more "user-friendly" manner. While it is not unusual to see a proxy refresh at a company following a "vote no" campaign or a particularly challenging year from an investor relations perspective, these are not the only reasons to consider a proxy refresh. Increasingly, companies are involving members of their investor relations team, external counsel and boutique design companies in assessing whether they may benefit from a review of their proxy statement's approach, appearance, and style. Executive compensation in particular has become a focus of the proxy refresh trend, with voluntary disclosures regarding realizable versus realized pay, pay for performance, non-employee director compensation and gender pay gaps coming sharply into investors' focus. We think it is likely that this trend will continue.

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A REMINDER: CHECK YOUR DISCLOSURE ON KNOWN TRENDS AND UNCERTAINTIES.

On June 15, 2017, the SEC entered an order instituting cease-and-desist proceedings against the former CEO and CFO of UTi Worldwide. The CEO and CFO each agreed to pay a civil money penalty of $40,000 to settle the proceeding, which alleged that they caused the company to violate Section 13(a) of the Securities Exchange Act of 1934 by failing to comply with the requirement of Regulation S-K Item 303 that it disclose "any known trends or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way." The U.S. Supreme Court recently granted *certiorari* in *Leidos, Inc. v. Indiana Public Retirement System*, No. 16-581, which presents the question of whether non-disclosure of "known trends or uncertainties" under Item 303 may give rise to private liability for securities fraud under Section 10(b) of the Exchange Act.

The analysis and disclosure of known trends and uncertainties is a central part of a company's MD&A, and the SEC's Division of Corporation Finance regularly issues comments on this aspect of MD&A. One reason for the frequency of comments is that companies may update financial and operational information, but may fail to step back and assess whether new trends are emerging. Known trends and uncertainties may include matters that may not otherwise be the subject of required disclosure if those matters may impact the company's liquidity, capital resources, and results of operations.

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