



Regulatory Update – Washington is Awake Again!

BankDirector.
#BDComp22

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Regulatory Update

Washington is Awake Again!

November 2022

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Executive Summary



SEC Rules – What Rules Have Been Finalized?



Universal Proxy
Card
(Nov, 2021)

Proxy Advisor
Firm Rule
(Jul, 2022)

Pay Versus
Performance
Regulation
(Aug, 2022)

Clawback
Regulation
(Oct, 2022)

*Public Company
Focused*

SEC Rules – Wait a Minute Are There More Rules Coming?

Current and Expected Proposed SEC Rules



*Financial Industry
Focused*



Concerns Regarding SEC Rules



26 new rule proposals introduced in 2022 (highest in past five years)

Both Senate Republicans and Democrats have questioned the SEC on overall pace

The SEC is losing staff at the highest levels in 10 years

Concern regarding litigation risk from a shortened industry comment periods

So Where Do We Go From Here?



Pay-versus-Performance

- Remember this impacts the upcoming 2023 proxy statement!
- Educate the compensation committee and executive management
- Begin the process of developing the exhibit
- 2020 and 2021 can be computed now

Clawback

- There is more time on this provision
- Review existing clawback policies relative to the final rules
- Analyze existing employment / CIC agreements and compensation plans to determine if any amendments are (will be) needed

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SEC Pay versus Performance Exhibit



SEC Adopts Final Pay Versus Performance Disclosure Rule

Background and Current Status

- In August 2022, the SEC adopted a final rule requiring companies to disclose information in their annual proxy statements reflecting the relationship between executive compensation actually paid by the company and the company's financial performance
 - This is not a Form 10-K disclosure item incorporated by reference into the proxy as is the rest of the executive compensation rules
- The rule was mandated by the Dodd-Frank Act of 2010 under Section 953(a)
- The SEC originally proposed this rule in 2015 and reopened the comment period in January 2022
- **The rule is effective for 2023 proxy season – new disclosures are required for proxy statements for fiscal years ending on or after December 16, 2022**
- **Companies Covered** – Required disclosure for all companies except for emerging growth companies, foreign private issuers, and registered investment companies (other than business development companies)
- **Limited disclosure for smaller reporting companies (SRCs)** – SRCs have reduced disclosure requirements

Overview of New Pay Versus Performance Disclosure Requirements

New Tabular Disclosure in Proxy Statement (*see sample on next slide*) :

- Total compensation as reported in the Summary Compensation Table for the Principal Executive Officer (CEO) and average of the total compensation for the other NEOs
- Compensation “actually paid” to the CEO and average of the amounts “actually paid” to other NEOs (Summary Compensation Table Total Compensation as adjusted for equity awards and pension values)
- Company’s TSR
- TSR of companies in the Company’s peer group
- Company’s net income
- A financial performance measure chosen by the Company

Transition Rule for Initial Disclosures – First pay versus performance table must disclose three most recent fiscal years, and an additional year of disclosure is added in each of the next two annual proxy statements. In addition, no disclosure is required for any fiscal year in which a company was not public.

Narrative or Graphical Explanation – **Must provide a clear description of the performance measure as compared to compensation actually paid, in narrative or graphical form, or combination, covering the following:**

- CEO and average NEO compensation actually paid to company TSR
- CEO and average NEO compensation actually paid to peer group TSR
- CEO and average NEO actually paid to company net income
- CEO and average NEO compensation actually paid to additional company-selected financial performance measure

SEC Tabular Disclosure – Required Format

| Year | Summary Compensation Table (SCT) Total for PEO | Compensation actually paid to PEO | Average SCT Total for non-PEO NEOs | Average Compensation actually paid to non-PEO NEOs | Value of Initial Fixed \$100 Investment based on: | | Net income | Company-selected measure* |
|---------|--|-----------------------------------|------------------------------------|--|---|-----------------|------------|---------------------------|
| | | | | | TSR | Peer Group TSR* | | |
| (a) | (b) | (c) | (d) | (e) | (f) | (g) | (h) | (i) |
| Year 1 | | | | | | | | |
| Year 2 | | | | | | | | |
| Year 3 | | | | | | | | |
| Year 4* | | | | | | | | |
| Year 5* | | | | | | | | |

No disclosure required for any fiscal year before the company became public. If a company had more than one CEO during the year, it would add another column (b) and (c) for each CEO.

Smaller reporting companies are not required to include items noted with an asterisk.

Calculation of Compensation Actually Paid

Pension Values

- Companies must deduct the aggregate change in the actuarial present value of all defined benefit and actuarial pension plans disclosed in the Summary Compensation Table, and then add back in service cost (actuarially determined for services for the most recent fiscal year) and the prior service cost (entire cost of benefits resulting from a plan amendment or initiation during the most recent fiscal year, for services rendered prior to the plan amendment)

Equity Awards

- Companies must deduct the equity compensation values disclosed in the Summary Compensation Table and add in revised values of both unvested and vested equity in each covered year of disclosure, in a manner consistent with the methodology in the Summary Compensation Table, using fair value as calculated in accordance with ASC Topic 718. More specifically:

| Award Type / Situation | Valuation Date / Methodology |
|--|--|
| For any awards granted in the covered fiscal year that are outstanding and <i>unvested</i> at year end | The fair value of those awards at year end |
| For any awards granted in prior years that are outstanding and <i>unvested</i> at year end | The change in fair value of those awards from the end of prior year end to the current year end |
| For any awards granted in the covered fiscal year that <i>vest</i> in the same year | The fair value of those awards at the vest date |
| For any awards granted in prior years that vest in a covered fiscal year | The change in fair value of those awards from the end of prior year to the vest date |
| For any awards granted in prior years that do not vest and are forfeited during the covered year | A deduction of the fair value of those awards calculated at the prior year end |
| For any dividends and earnings paid on awards in the covered fiscal year prior to the vest date | The total value of such dividends and earnings that are not already included in the calculation of fair value of the award |

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SEC Clawback Rule



SEC Adopts Final Clawback Policy Rules

Background and Current Status

- In October 2022, the SEC adopted a final rule requiring companies to develop a clawback policy consistent with their primary exchange.
 - A company will be required to file their clawback policies with the SEC
- The rule was mandated by the Dodd-Frank Act of 2010 under Section 954
- The SEC originally proposed this rule in 2015 and reopened the comment period in January 2022
- **Timing** - The exchanges have 90 days to propose their rules after the SEC's rule is published in the Federal Register and must be effective no later than one year after the SEC rule is published. Once the listing exchange standards are effective, companies will have 60 days to adopt a compliant clawback policy. **Expect this will be effective at some point in the later half of 2023, potentially impacting the 2023 10K filings.**
- **Companies Covered** – Required disclosure for all public companies *including* for emerging growth companies, foreign private issuers, and smaller reporting companies (SRCs). **This is much stricter than the Pay versus Performance exhibit as to scope of companies affected.**

Overview of New Clawback Policy Requirements

Core of requirements:

- Adopt a clawback policy meeting the requirements of the rule / listing standard,
- Comply with the clawback policy, and
- Make required disclosures about the clawback policy.

Required Disclosures:

- Companies will be required to file their clawback policies with the SEC as an exhibit to their annual reports.
- Companies will also have to disclose any restatement and any application of their clawback policy by checkmark on the cover of their annual report

Definition of Restatement Covers:

- Corrections of material errors made by restating prior period financial statements (“Big R”), and
- Corrections of non-material errors to previously issued financial statements or that are corrected for a current period financial report (“little r”)
- *Aon: This is one of the largest differences in the 2015 proposal to the final rule*

Misconduct:

- The new rule does not address the inclusion of a trigger based on misconduct unrelated to a financial restatement.
- *Aon: Many companies’ current clawback policy include such a trigger; we expect that these companies may retain this provision.*

Fault:

- Compensation must be subject to the clawback regardless of any fault of the executive officer for the accounting errors that led to the restatement.
- *Aon: Many companies’ current policies stated that in order to clawback compensation, the executive was required to have been at fault or a direct supervisor for the accounting restatement.*

Components of New Clawback Policy Requirements

Covered Officers:

- Definition: Section 16 officers + officers listed in the Company's 10K or officers in proxy who have bios
- Any officer who served in this role for the three-year lookback period; however, does not apply to period before being deemed an executive

Forms of Compensation Covered:

- All cash or equity-based incentive compensation that is granted, earned or vested based wholly or in part upon the attainment of a financial reporting measure regardless of when it is paid
- This includes all types of equity awards unless they vest solely over time.
- *Aon: Grants and awards that are subject only to time-based conditions or performance conditions that are not related to financial measures such as achievement of a business milestone would not be deemed incentive-based compensation for these purposes*

Compensatory Amount Subject to Clawback:

- Amount of incentive-based compensation received that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the restated amounts, computed without regard to any taxes paid
- For incentive-based compensation based on stock price or total shareholder return, where the amount of erroneously awarded compensation is not subject to mathematical recalculation directly from the information in an accounting restatement, the amount must be based on a reasonable estimate of the effect of the accounting restatement on the stock price or total shareholder return upon which the incentive-based compensation was received.
- *Aon: Many existing policies allow for taxes already paid to be subtracted when calculating the recoupment amount. Also, determining "reasonable estimate" for stock related measures will be a challenge.*

In Summary

*Let's
Recap*

Washington is Active

- There are more rules coming
- Human capital management, climate change and ESG, board diversity and incentive-based compensation arrangements

Pay-versus-Performance

- Remember this impacts the upcoming 2023 proxy statement!
- Educate the compensation committee and executive management

Clawback

- There is more time on this provision
- Review existing clawback policies relative to the final rules

Appendix

SEC Actions – Finalized,
Proposed and Future
pronouncements



SEC Regulatory Update – Final Rules

| Topic | Dodd-Frank Executive Compensation Final Rules |
|--|--|
| <p>Clawback Policy</p> <p>Effective once finalized and implemented by the stock exchanges (expected within one year)</p> | <p>On October 26, 2022, the SEC voted to finalize the Dodd Frank mandated Executive Compensation Clawback Rules. New Exchange Act Rule 10D-1 will require companies to adopt, comply with and provide disclosures on their executive compensation recovery policy.</p> <ul style="list-style-type: none"> The rule generally provides that a company recover from any current or former executive officers' incentive-based compensation that was erroneously awarded during the last three completed fiscal years. The rule applies to all companies listed on an exchange, including Emerging Growth Companies (“EGCs”), Smaller Reporting Companies (“SRCs”), Foreign Private Issuers (“FPIs”) and controlled companies. The rules require Nasdaq and NYSE to adopt listing standards to implement the policy. Companies will be required to adopt a compliant clawback policy, which will be required to be filed as an exhibit to the Form 10-K as well as disclose when the clawback policy is applied in its proxy statement. |
| <p>Pay Versus Performance Disclosure Rules</p> <p>Effective for disclosure for fiscal years ending on or after 12/16/2022</p> | <p>On August 25, 2022, the SEC adopted the Dodd Frank mandated Pay-versus-Performance Disclosure Rules requiring companies to provide for the 5 most recently completed fiscal years (3 years in the first year of filing and adding another year of disclosure in the next 2 subsequent years):</p> <ul style="list-style-type: none"> Include a table disclosing the “compensation actually paid” to the CEO and an average for the other NEOs (calculated as required by the rule), as well as the following company financial performance measures: TSR, TSR for the company’s peer group (the published industry or line-of-business index used in the TSR graph of the annual report or the peers used to determine compensation as disclosed in the CD&A), net income, and a financial performance measure chosen by the company which, in the company’s assessment, represents the most important financial performance measure used to link “compensation actually paid” to the NEOs to company performance for the most recently completed fiscal year. Provide a list of three to seven performance measures that the company believes are the most important measures linking pay to performance for the most recent fiscal year. Companies are permitted, but not required, to include non-financial measures in the list if they considered such measures to be among the “most important” measures. <p>The rule does not apply to EGCs or FPIs nor is disclosure required for any year a company is not public. SRCs must comply for the 3 most recently completed fiscal years (2 in the first year of filing adding another year of disclosure in the next year) and the disclosure is more limited (e.g., no peer group). Companies must comply with the new disclosure requirements for the 2023 Proxy Season.</p> |

SEC Regulatory Update – Final Rules

| Topic | Update |
|---|--|
| Universal Proxy Card Rule | <p>In November 2021, the SEC adopted rules to require the use of universal proxy cards in all nonexempt solicitations for contested director elections</p> <ul style="list-style-type: none"> • Under the new rule, a proxy card must include both the company and the dissident nominees on the same card to allow shareholders to choose the best slate of directors by choosing directors on an individual basis. • Each party in a contested election will have to include references in its proxy statement to the other party's proxy statement for information on the other party's nominees. The rule will take effect for shareholder meetings after August 31, 2022 and is expected to result in increased proxy contests and shareholder activism. |
| Proxy Advisory Firm Rule Effective 9/19/2022 (subject to ongoing litigation) | <p>On July 13, 2022, the SEC voted to amend the final proxy advisory firm rules issued in July 2020.</p> <ul style="list-style-type: none"> • The amendment leaves in place the rule that proxy voting advice is a proxy solicitation, but that proxy voting advice may be exempt from the content and filing requirements of the proxy rules if the proxy advisory firm meets certain conditions. • The amendment eliminated the two company friendly conditions: <ul style="list-style-type: none"> ○ Require proxy advisory firms to make their reports available to the company at or before the time the report is made available to its clients. ○ Require proxy advisory firms to make a company's response to its report available to clients. <p>Proxy advisory firms will no longer need to meet these two pro-company conditions to receive the exemption from the proxy solicitation rules and the tension between proxy advisory firms and companies will continue.</p> |

SEC Regulatory Update – Proposed/Potential Rule Proposals

| Status | Topic | Update |
|----------------|-----------------------------------|--|
| PROPOSED RULES | Share Buyback Rule | In December 2021, the SEC proposed a rule requiring companies to provide disclosure on a new Form SR when the company executes a share repurchase . The company would need to disclose each share repurchase within one business day of the transaction. |
| | Climate Change and ESG Disclosure | In March 2022, the SEC proposed rules that would require publicly traded companies to include climate-related disclosures (including material climate risks, management systems, and emission metrics) in registration statements, Form 10-K, and Form 10-Q reports. <ul style="list-style-type: none"> If the rules are finalized, the earliest fiscal year companies would be required to report on would be FY 2023 for large accelerated filers, FY 2024 for accelerated and non-accelerated filers, and FY 2025 for smaller reporting companies. |
| | Insider Trading Plans | The SEC proposed amendments to Rule 10b5-1 in December 2021 to address concerns of “apparent loopholes” benefiting corporate insiders. <ul style="list-style-type: none"> The proposal includes a 120-day mandatory cooling off period for officers and directors before trading. Companies will also be required to disclose on a quarterly basis in the Form 10-Q/10-K the material terms of the 10b5-1 plan including the date of adoption or termination, the duration of the plan or arrangement, and the number of securities to be traded. |
| | Cybersecurity Risk Governance | In March 2022, the SEC proposed cybersecurity disclosure rules which specify how companies should disclose cybersecurity incidents as well as adequately describe risk management, governance oversight, and cybersecurity expertise of board members. |

SEC Regulatory Update – Proposed/Potential Rule Proposals

| Status | Topic | Update |
|-------------------------------|--|--|
| POTENTIAL RULE PROPOSAL | Human Capital Management Disclosure | <p>Effective November 9, 2020, the SEC requires that companies discuss human capital management in the Form 10-K based on “principles-based” disclosure.</p> <ul style="list-style-type: none"> SEC is considering recommending a proposal to enhance these disclosures with specific metrics and information. |
| | SEC Corporate Board Diversity | <p>The SEC may recommend amendments to its disclosure rules to enhance disclosure in filings (including proxy statements) to add information regarding the diversity of board members and nominees.</p> |
| | Dodd-Frank Executive Compensation Rule (Incentive-Based Compensation Arrangements) | <p>The SEC has commented that they may be looking to finalize Section 956, “Incentive-Based Compensation Arrangements” under Dodd-Frank. This provision proposed in 2011 and repropose in 2016 applies to both banks, credit unions, federal home loan banks. As an interagency rule, this rule has to be approved by all representative agencies.</p> <ul style="list-style-type: none"> SEC has commented that it is looking to potentially finalize this rule, which may make for a completed set of rules from Dodd-Frank. |