2023 Proxy Season Preview

FIVE KEY EXPECTATIONS

1. Universal proxy card rules are the most significant change in corporate governance since say-on-pay and will amplify already complex proxy fight dynamics
2. Investors will go back to basics with a focus on the board as voting policies and engagements prioritize board composition and accountability
3. Say-on-pay votes will be impacted by the broad market downturn as investors consider how pay aligns with their experience; inaugural pay versus performance disclosures will introduce new complexity
4. Companies and investors will contend with continued high volume of shareholder proposals, many of which are more targeted to company circumstances
5. Large asset managers will act to offset ESG backlash and challenges they are facing as a result of their influence

HOW BOARDS AND MANAGEMENT TEAMS CAN PREPARE

> Anticipate that investor pressure on companies will grow following volatile market conditions in 2022 and what may be a challenging earnings season for some

> Showcase the board's composition to give investors deeper insight into boardroom dynamics, individual and collective director contributions and how the board is effective in its oversight

> Ensure engagement programs continue to meet investor expectations, including director and senior management participation, cadence of meetings and tailored agendas for effective dialogue

> Watch for further shifts as the SEC is expected to finalize rules on climate risk and cybersecurity and issue proposed rules on human capital management and board diversity

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1 | Universal Proxy Card Reshapes the Landscape

With the first proxy fights under the new universal proxy card rules in the books, and a challenging macro environment, the stage is set for a wave of potential campaigns this proxy season. What is clear at the outset is that dynamics and leverage in activist campaigns will shift under the new rules. Proxy fights will become more personal and political, with heightened scrutiny on the backgrounds and track records of individual directors. New activists are likely to emerge as barriers to entry are lowered – this may result in nominations of “special interest” candidates by certain investors seeking to advance single-issue causes such as climate progress or labor rights

Much of the attention to date for companies and investors has been around proxy voting mechanics, as companies seek to control the nomination process through amendments to their advance notice bylaws. These changes have ranged from procedural to more restrictive. The investor consensus is that nomination procedures should not be overly onerous and that requirements for dissident nominees should be the same as the company’s nominees

2 | Investors Go Back to Basics with Renewed Focus on the Board

In challenging markets, investors re-prioritize focus on the important role directors play in representing their interests in the boardroom. Investor policy updates and engagement priorities for 2023 indicate renewed attention to the qualifications and contributions of both individual directors and the collective group. This includes how the board uses its evaluation process to identify any gaps in skills or experience, how the board exercises its oversight role and a refined approach to understanding how the board identifies and manages material ESG factors

Investors have also indicated a continued focus on overboarding, including greater expectations for company disclosure around how the board sets, monitors and enforces director commitment policies, as well as modifications to some investor policies to count board and committee leadership roles as multiple board seats

3 | Say-on-Pay will Receive Elevated Scrutiny Amidst Challenging Markets

Investors will expect that annual and long-term incentive payouts reflect their experience, which will present challenges for some companies following the worst performing year for equities in recent history. The flexibility investors provided during COVID is not likely to return – any actions outside of established plans such as positive discretion, one-time awards and large inducement grants will be heavily scrutinized. Equity plan proposals are a potential pressure point as stock plans are being exhausted more quickly due to lower share prices and broader use of equity for retention – expect close analysis of share requests where dilution or burn rates are high

While pay versus performance disclosure will generally not be included in pay-for-performance models in this initial year of the rule, companies should expect disclosure to be more closely reviewed where there is some concern with pay practices. In instances where the relationship between the new "Compensation Actually Paid" figure and the metrics required to be disclosed (absolute and relative TSR, Net Income and a selected metric) is not clear, investors may seek greater understanding of why compensation outcomes are appropriate

4 | Shareholder Proposals are Numerous and Increasingly Company-Specific

Shareholder proposals for 2023 annual meetings will cover an extensive range of topics, with a heavy focus on human capital and social policies and impacts. As investors communicate that they have a higher bar to support some environmental and social proposals and take a more case-by-case approach to their analysis, proponents are building stronger company-specific arguments for their proposals. Companies are taking a more direct approach to opposing proposals by clearly stating why a particular request would be costly, unnecessary or introduce risk and disclosing proponent names in proxy statements so that the context of the proposal is fully understood

It is also expected that “anti-ESG” proponents will continue to leverage their platform around annual meetings to create additional pressure on companies to defend their practices on topics including diversity, human rights and political spending alignment

5 | Asset Managers Take Action to Offset Growing Pressures

Large asset managers have put forth fewer significant policy changes for 2023. These updates have come amidst a politically-charged market environment that has put asset managers’ stewardship approach, size and influence under increased scrutiny. Some are moving away from using “ESG” as an umbrella term but remain committed to holding companies accountable on significant environmental and social risks through votes against directors and support for well-targeted shareholder proposals. At the same time, a number of asset owners have continued to publicly urge asset managers to stay the course, and even enhance, their stewardship efforts around climate risk and other sustainability topics

BlackRock, State Street Global Advisors and Vanguard have all introduced or expanded proxy voting programs to further involve institutional and retail clients in the proxy voting process (“vote choice”). While these initiatives may have a broader impact on voting and engagement over time, in the near term, they will enhance the influence of proxy advisor recommendations and make it more challenging for companies to identify votes and drive support

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