Preparing for 2021 Compensation and Human Capital Disclosures

As we enter 2021, most businesses are still feeling the global economic repercussions of the COVID-19 pandemic. Looking back at 2020, one of the biggest takeaways is how uniquely the pandemic and resulting economic uncertainty impacted individual industries and companies. It is difficult to draw sweeping conclusions about the pandemic's effects. We know that some industries fared better than others, and some companies found immense success as the world of work transformed overnight. For example, tech companies like Zoom and CrowdStrike (a cybersecurity firm) saw immense increases in market value as remote work became the default. Supermarkets and home improvement retailers like Lowe's and Home Depot benefited from all the extra time people spent at home. On the other hand, discretionary retail, travel, and hospitality businesses suffered immensely.

The highly individualized impact of COVID-19 means companies must take extra time and care when crafting their CD&A disclosures to appropriately tell their stories. While there were no major changes to SEC compensation disclosure requirements for 2021, the SEC did implement new rules for the business description in the 10K filing. Companies are now required to describe their human capital resources, from the number of employees to talent metrics like employee engagement and diversity. As companies draft their compensation and human capital disclosures, there are specific considerations companies should take to adequately communicate the pandemic's impact on the company and employees, and what steps the company took to face these challenges.

Compensation Disclosures

The SEC requires publicly traded companies in the United States to disclose compensation decisions for proxy-named executive officers. They are required to describe the actions taken by the board and compensation committee to build those compensation plans, including the rationale for the decisions. Meridian's recent client survey indicates that while most companies did not take material action to change their compensation plans, some did. Either way, in the wake of the pandemic, it is more important than ever for companies to approach the proxy and CD&A with a fresh set of eyes and include these steps in the process:

- **Tell your COVID-19 story.**
  It is critical that the CD&A adequately expresses the full scope of the pandemic's impact. It should clearly illustrate the overall impact on the company, the effects on employees, and the steps the company took to cope with the challenges. For organizations that made changes to annual or long-term incentive programs, the narrative should specifically highlight how the impacts of the pandemic influenced those changes.

- **Review perquisite disclosures.**
  In summer 2020, the SEC identified a few companies that were not appropriately disclosing perquisites in the proxy. As a result, the SEC provided additional clarification on how companies should do this. Specifically, companies need to define what is a perquisite and

what is not. Companies should review these clarifications, both as they pertain to COVID-19 and in general.

- **Examine last year's say-on-pay vote.**
  If your company received votes and vote support for say-on-pay that was anywhere below 90%, that is a call to action to initiate more discussion about how the committee viewed those results and what they did in response. There are certain thresholds even below that level that compel a committee to take meaningful action, often engaging directly with shareholders to understand their concerns regarding compensation programs. Companies should disclose what actions the committee took in response to that feedback.

Human Capital Disclosures

In November 2020, the SEC implemented new rules for the business description in a company's 10K filing. Unlike rules for compensation disclosures, there is far more flexibility in what a company can or should include. These rules are principles-based, which means the SEC offers examples and lists of topics companies can consider, but these examples stop short of providing detailed prescriptive guidelines on what exactly a company must include. Depending on the company, these disclosures could include a variety of workforce metrics including retention and turnover, diversity and inclusion, health and safety, oversight, and more.

Organizations should begin exploring what to include by forming a cross-functional team that includes HR, legal, finance, and perhaps others to discuss which policies, practices, and metrics might make the most sense. Some necessary steps here include:

- **Identify what data is currently available.**
  In large organizations, people data is often tracked across departments and platforms. These systems may or may not talk to each other. Across organizations, there is a wide range of proficiency when it comes to people analytics, from retroactive reporting to true predictive and prescriptive analytics. Where your company falls on this spectrum will have a significant impact on the data you can and should present.

- **Consider what your audience already knows.**
  What messages about your company's human capital resources are already out there, both internally and externally? What do your marketing and recruiting departments tell their audiences about who your company is? Do these messages align with the organizational strategy, and are there metrics that support the validity of these messages?

The significance of the SEC's new human capital disclosure rules cannot be overstated. These rules were left largely unchanged for nearly 30 years. They now allow organizations to modernize the insights investors have into public companies.

Housekeeping

As companies review and finalize their CD&A disclosures, it is important to factor in readability and accessibility into the final documents. Disclosures should be written in plain language, devoid of run-on sentences and long paragraphs. Metrics and numerical data should be presented in clear graphs and charts.

Companies must take extra care to present information in the format the SEC requires. For example, the SEC has very prescribed rules for where annual incentives or bonuses for executives for the year should be disclosed in the Summary Compensation Table. Usually, incentives and bonuses based on performance metrics are disclosed in the non-equity incentive plan compensation column. The bonus column should be reserved for discretionary bonuses. If a company has made changes to its annual bonus structure, it is necessary to review these disclosure requirements and to ensure annual bonus payments are properly disclosed.

Conclusion

2020 and the COVID-19 pandemic affected businesses in a variety of ways, both positive and negative. For public companies, proxy statements and CD&A disclosures provide an opportunity to tell the full story of how they coped with the pandemic and associated economic turmoil. The SEC's new human capital disclosure rules are highly significant in that they provide shareholders with a new perspective into the health of the workforce and a clearer picture of all the factors contributing to that company's success. At Meridian, we expect to see a great deal of evolution in human capital disclosure statements as organizations decide what metrics are important, improve at measuring and analyzing those metrics, and better align talent and people outcomes with organizational strategy.