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## SEC Publishes its Observations of Executive Compensation Disclosure

By Kelly Simoneaux and Nathan List

On October 9, 2007, the staff of the Securities and Exchange Commission Division of Corporation Finance (the “Staff”) published its observations on its initial review of the executive compensation disclosures of 350 public companies. On the same day the observations were published, John W. White, director of the division of Corporation Finance, spoke at the 2<sup>nd</sup> Annual Proxy Disclosure Conference in San Francisco, emphasizing certain areas of particular concern. A transcript of Mr. White’s speech is available here.

The Staff’s report outlined two primary themes. First, the Compensation Discussion and Analysis, or CD&A, should focus on *how* and *why* a company arrives at specific executive compensation decisions and policies. Second, presentation matters. Disclosures should be clear, concise, and understandable and companies should consider presenting layered disclosure including tables and graphs to help investors understand the large amounts of information required to be disclosed. The Staff also expressed comments on other aspects of disclosure, including corporate governance.

### CD&A - Focus on “Analysis”

The main focus of the Staff’s comments and Mr. White’s speech was the general lack of meaningful analysis in the CD&A. In future proxy statements, companies are encouraged to enhance the discussion of *how* they arrived at a particular level and form of compensation and *why* they pay that compensation. The CD&A should give investors an *analysis* of the results of the company’s compensation decisions, and the Staff noted the following methods to improve disclosure:

- ***De-emphasize mechanics and focus on the analytical process and results.***

Companies tended to describe compensation philosophies and decision mechanics in great detail. Companies should refocus this description to emphasize the substance of compensation decisions and to describe how the company collected and analyzed information and how this analysis resulted in the compensation it paid. Further, companies should explain how and why the determinations regarding one element of compensation may or may not have effected decisions made as to other compensation elements. Additionally, where policies or decisions for individual named executive officers appear to be materially different based on the disclosure, companies should discuss these differences.

- ***Disclose performance targets.***

The Staff issued more comments addressing performance targets than any other topic. When prior or current year performance targets are material to the company’s compensation policies and decision-making, the company should disclose the targets, or

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demonstrate that disclosure of the targets could cause competitive harm. Mr. White commented that in addition to disclosing the targets, companies should discuss how the targets were used in awarding compensation. If the company withholds disclosure of the targets, it must specifically disclose the difficulty or likelihood of achieving the targets.

- *Enhance discussion regarding benchmarking.*

When companies use compensation information from other companies to determine their own compensation levels, they must disclose how comparative compensation information was used and how that comparison affected compensation decisions. When a company uses comparative compensation information but retains discretion in the use of that information, the company needs to include a description of the nature and extent of the discretion and whether or how it exercised that discretion.

- *Enhance discussion of termination and change-in-control arrangements.*

Companies are expected to not only describe the material terms and payment provisions in change-in-control and termination arrangements, but also to explain why the arrangements were structured as they were. Companies should also describe how payments and benefits under these arrangements affected their decisions regarding other compensation elements.

### **Presentation Matters**

The Staff suggested the following methods to improve clarity of presentation:

- Emphasize material information and de-emphasize less important information. For example, emphasize *how* and *why* the company established compensation levels and move the discussion of the mechanics and processes of compensation programs to the narrative explanations following the compensation tables.
- Consider presenting information in additional charts, tables, and graphs where appropriate, and include total amounts in tables presenting potential payments on termination or change-in-control.
- Ensure that alternative summary compensation tables are de-emphasized and clearly identified, and clearly explain the differences between the required and alternative tables.
- Be more clear about *how* and *why* specific executive compensation decisions are made. The Staff noted that improved analysis does not necessarily mean a longer disclosure, rather “careful drafting consistent with plain English principles could result in a shorter, more concise and effective discussion that complies with our rules.”

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- Replace boilerplate language with a clear and concise discussion of specific facts and circumstances.
- Provide a clear and concise analysis of the narrative information supplementing the required tables and avoid repetition.
- Be mindful of font sizes in tables and footnotes.

### Corporate Governance

The Staff comments on corporate governance focused on who was involved in making compensation decisions. Companies should disclose exactly who made compensation decisions, describe the role of the companies' principal executive office in making compensation decisions, and specifically disclose the nature and scope of consultants' assignments and material instructions consultants were given by the company.

### John White's Suggestion

In his speech, Mr. White suggested that prior to drafting the CD&A, companies should consider having each key participant in the compensation decision process prepare a one-page, bullet-point list of what he or she considered the material "hows" and "whys" of the process. Such a list might include the following:

- the key analytic tools used by the compensation committee;
- the findings that emerged from the analysis; and
- the resulting actions impacting executive compensation in the last year.

*Please remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues you may contact the head of our Corporate and Securities practice group:*

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