

2008 Proxy Season: Focusing on Your Executive Compensation Disclosures

Earlier this year, the SEC's Division of Corporate Finance completed its review of the 2007 executive compensation disclosures of approximately 350 companies. Based upon this review, and in preparation for the 2008 proxy season, we have prepared our "Top Ten Issues" for companies to consider as they prepare their annual compensation disclosures.

Issue #1: Focus on the "A" in the Compensation Discussion and Analysis (the "CD&A"). The key issue, at least in the CD&A, is not so much what is being provided to your executive officers (which will likely be found in the applicable tables), but *how* and *why* your company made its compensation decisions. In particular, explain and place in context why the company chose to pay each element of compensation. The SEC is not simply looking for a discussion of the goals, policies and individual elements of the package, but how the entire package fits together and why it works or should work.

Issue #2: Elaborate on the impact of benchmarking. If the benchmarking involved peer group analysis, identify the peer groups by name and explain how and why the peers were selected. Further, in the discussion of your performance targets, explain how you accounted for the individual performance of the Named Executive Officers ("NEOs") and how individual performance affects each element of compensation. Also, disclose the performance targets and, if you believe disclosure of the performance targets could cause harm, explain your rationale for such a conclusion. If the disclosure of the target is being withheld on a competitive harm basis, discuss the degree of difficulty you expect your NEOs to have in reaching their targets. Consider describing historical levels of achievement or attainment of targets; using boilerplate language, such as the "targets are a stretch," is insufficient.

Issue #3: Discuss the role of your outside advisors. If you engaged outside consultants, what directions were they given? Identify each consultant by name, and clarify each consultant's duties and role in establishing compensation for the NEOs.

Issue #4: Highlight the differences in compensation among your NEOs. Explain why the Principal Executive Officer's ("PEO's") compensation is higher than that of the other NEOs. The SEC has been focusing on why there are material differences in compensation policies and decisions for individual NEOs. Explain why internal pay differences exist. When describing the PEO's compensation, disclose its material terms and the reasons behind its design and structure. John White, Director of the SEC's Division of Corporate Finance, specifically noted the importance of a wealth accumulation analysis in explaining the types and levels of compensation provided to NEOs.

Issue #5: Detail the triggers for severance and change-in-control payments. Explain how, why and whether severance, termination and/or change in control terms were the result of negotiations or an evaluation of benefits provided by peer companies. Provide a table and/or tally sheet for the compensation provided upon termination to each NEO. Explain how and whether your company applied a wealth accumulation analysis in its severance and change-in-control policies.

Issue #6: Focus on the format of the presentation, since the manner of presentation matters. Use plain English — the goal is concrete, everyday words. Use charts, headings, tables, tally sheets and graphs. Consider using a table in the CD&A that details each element of compensation and describes how and why these elements were used. Do not try to "hide the ball," but, similarly, the SEC is not expecting a dissertation. Do not write too much or too little.

Issue #7: Remember the ultimate goal of the CD&A. The intent of the CD&A is to provide shareholders with a window into the Compensation Committee's thinking, not merely the end result. Accordingly, the SEC does not believe that the CD&A should be similar among companies; a boilerplate CD&A should not exist.

Issue #8: Expand the summary compensation table. Consider using one or more sub-tables to detail the components of the column relating to "All Other Compensation." This may make it easier for the reader to understand your disclosures.

Issue #9: Involve all key participants in the process. As Mr. White suggested, prior to drafting the CD&A, have every participant — from the Compensation Committee chairperson on down — submit a one-page analysis to address: (i) the analytic tools the Compensation Committee uses, (ii) the findings that emerged from the analysis, and (iii) the resulting actions.

Issue #10: Discuss the roles of the NEOs in corporate governance. The SEC review focused on who was involved in making the compensation decisions. Any role played by NEOs in executive compensation decisions will therefore need to be disclosed and explained.

Interestingly, the SEC has stated that companies need only disclose the “material” elements of compensation. Its comments, however, suggest that the SEC views almost all elements of compensation as “material.” Ultimately, companies are responsible for determining exactly what rises to the level of materiality. All of this being said, we do not expect any further guidance from the SEC prior to the preparation of your 2008 proxy. In the end, focus on the following key issues:

- more analysis: “why” and “how”
- more disclosure of performance goals and targets
- clear presentation style

The preparation of thorough disclosures requires time, patience and openness.

New York Office

+1 212.836.8000

London Office

+1 44.20.7105.0500

Chicago Office

+1 312.583.2300

Frankfurt Office

+1 49.69.25494.0

Los Angeles Office

+1 310.788.1000

Shanghai Office

+1 86.21.2208.3600

Washington, DC Office

+1 202.682.3500

West Palm Beach Office

+1 561.802.3230

Copyright ©2007 by Kaye Scholer LLP. All Rights Reserved. This publication is intended as a general guide only. It does not contain a general legal analysis or constitute an opinion of Kaye Scholer LLP or any member of the firm on the legal issues described. It is recommended that readers not rely on this general guide but that professional advice be sought in connection with individual matters. References herein to “Kaye Scholer LLP & Affiliates,” “Kaye Scholer,” “Kaye Scholer LLP,” “the firm” and terms of similar import refer to Kaye Scholer LLP and its affiliates operating in various jurisdictions.