

SEC Issues Staff Report on Executive Compensation Disclosure

Overview

The SEC staff reviewed the executive compensation disclosure of 350 public companies to assess their compliance with the new disclosure rules. On October 9, 2007, the staff published its much-anticipated report on this review. Although the report offers valuable guidance on how to improve executive compensation disclosure in the upcoming proxy season, it doesn't serve as the "how-to" guide to proxy disclosure that many companies and lawyers had hoped it would.

The Importance of Presentation

The staff emphasizes that the manner of presentation of executive compensation disclosure matters. Plain English requires clear and concise descriptions that highlight how and why companies established their compensation levels - not lengthy, boilerplate discussions of compensation program mechanics. Although the staff encourages companies to provide ancillary charts, tables and graphs when they are helpful, they should not interfere with the presentation of the required tables. For example, the staff cautions against giving prominence to an alternative summary compensation table that calculates compensation amounts in a manner inconsistent with the rules or that might lead a reader to assume that the alternative table was part of the required compensation tables.

The Shortcomings of Compensation Discussion and Analysis

Substance matters too. The report, along with a speech that Corporation Finance Director John White gave on the day the report came out, stresses that the Compensation Discussion and Analysis ("CD&A") for many companies failed to explain **how** and **why** they arrived at specific compensation decisions. The following are a few of the shortcomings cited:

- There were more comments on performance targets than on any other disclosure topic. If it appeared that corporate and individual performance targets were material to the company's compensation decisions, the company was asked to disclose them and explain how they were used and how they affected compensation. Although targets need not be disclosed if disclosure would cause competitive harm, it seems clear that the staff believes the instances where confidential treatment is warranted - particularly for prior year targets - are few. The staff also sought more specific disclosure where a company omitted the target but disclosed its degree of difficulty.
- In a more widespread comment than was anticipated, the staff requested disclosure of current year performance targets "where a company's disclosure implied that its current or prior year performance targets were material . . . we asked it to disclose prior year and current year targets." The report is not clear in what circumstances company disclosure would "imply" the importance of current year targets in understanding last year's compensation. Where performance targets are necessary to place a named executive officer's compensation in context, such as where a company has a new or multiple year compensation plan or where target levels vary materially across several years, current year targets should be disclosed.
- Companies should avoid lengthy descriptions of compensation philosophy or the mechanics of the decision-making process. Instead, they should describe how the philosophy or the process resulted in the types of compensation they chose to award and the numbers that appear in the tables.

- Many of the companies that the SEC staff reviewed failed to describe how paying or awarding one element of compensation influenced decisions to pay or award another element of compensation. For example, a recurring comment was to disclose how potential payments and benefits under change of control arrangements might influence the amount or type of compensation in other areas. Likewise, companies should address the impact previously realized compensation had or will have on compensation policies or specific awards.
- If a company uses other companies to benchmark its compensation decisions, it should identify the benchmark and, if applicable, its components (including component companies). It should also explain how it uses this comparative information and how that comparison affected compensation decisions. If there is broad discretion in how benchmarking is used, or in whether benchmarking is used at all, that should also be disclosed.
- Finally, a company's CD&A should be sufficiently precise to capture material differences in compensation policies with respect to individual named executive officers. For example, in many cases, this means providing a more detailed discussion of how and why awards granted to a company's chief executive officer differ from the compensation and awards granted to other named executive officers.

These are only a few of the topics covered by the report. We recommend that all individuals preparing compensation disclosure review the full report and begin considering the ways in which their companies can improve disclosure in the upcoming proxy season. In addition, in his October 9 speech, John White recommended that all individuals preparing compensation disclosure begin this fall by answering three questions on a single sheet of paper:

- What are the key analytic tools that the compensation committee used?
- What are the findings that emerged from that analysis?
- What were the resulting actions taken impacting executive compensation in the last year?

The report, including the press release announcing the report, can be found at <http://www.sec.gov/news/press/2007/2007-214.htm>. John White's speech can be found at <http://www.sec.gov/news/speech/2007/spch100907jww.htm>.

Contact Information

If you would like to learn more about the staff report, please contact your usual legal advisor at Ropes & Gray.

