

Client Alert

Latham & Watkins
Corporate & Tax Departments

SEC Staff Publishes its Observations from its Review of Executive Compensation Disclosures in 2007 Proxies

On October 9, 2007, the staff of the US Securities and Exchange Commission's Division of Corporation Finance (the Staff) published a report summarizing its observations from its initial review of the executive compensation disclosures in proxy statements filed this year by 350 public companies. The report completes the second phase of the Staff's "targeted review project" on the implementation of the SEC's 2006 comprehensive amendment of the proxy compensation disclosure rules.

In the first phase of the project, the Staff issued comment letters to these companies concerning the executive compensation disclosures in their 2007 proxies. The report, which is available at <http://www.sec.gov/divisions/corpfm/guidance/execcompdisclosure.htm>, discusses the principal areas the Staff commented on. To view our recent *Client Alert* reviewing the Staff's comment letters, please [click here](#).

In connection with the publication of the Staff's report, John White, the Director of the Division of Corporation Finance, gave an important speech at the 2nd Annual Proxy Disclosure Conference in San Francisco amplifying on the report, in which he stated his overall assessment that "the positives are substantial" and that "investors have been provided with the most

comprehensive disclosure ever regarding how much public companies pay their executives and directors." But Mr. White also stated that there was a need for improvement in "some very important areas" and that the greatest shortcoming of the disclosures was in their failure to provide "meaningful analysis."

Two main themes emerged from the Staff's report. First, the Staff continues to believe that the Compensation Discussion and Analysis (the CD&A) section needs to be clear, concise, understandable and focused on how and why compensation committees make specific compensation decisions. Second, the manner of presentation is key. The compensation disclosure needs to be in plain English and techniques such as executive summaries, overviews and layered disclosure should be used in tandem with charts and graphs to present executive compensation information in a way that helps readers better understand the company's plans, policies and practices.

Compensation Discussion and Analysis

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- **Analysis.** Companies have been asked to focus their CD&As on how they analyzed compensation information and why their analysis resulted in particular forms and amounts of compensation. The key points of such an analysis and disclosure, as discussed by Mr. White in his speech, include, as appropriate: (1) the key analytic tools used by the compensation committee; (2) the findings that emerged from the analysis; and (3) the resulting actions taken impacting executive compensation in the prior year.
- **Performance targets.** With respect to the disclosure of performance targets, a company first needs to determine if its use of prior year and/or current year performance targets are material elements of its compensation policies and decisions. If they are not, they do not need to be discussed. But if they are, the company is required to disclose these prior year and/or current year targets unless it is able to demonstrate that disclosure of these targets would result in competitive harm. If the company withholds disclosure of these targets on the basis of competitive harm, it needs to disclose with specificity the difficulty or likelihood of achieving the targets.
- **Difference in compensation policies and decisions.** Where policies or decisions for individual named executive officers appear to be materially different based on the disclosure, companies have been asked to discuss these differences.
- **Benchmarks.** Where companies state that they use comparative compensation information, they have been asked to provide a more detailed explanation of how they used this information and how the information affected their compensation decisions.
- **Change-in-control and termination arrangements.** Companies have been asked to disclose the basis for the material terms and payment provisions in their change-in-control and termination arrangements.
- **Corporate Governance.** Companies have been asked to describe more specifically the role of their principal executive officers in making compensation decisions, as well as the role of, and any material instructions provided to, their compensation consultants.

Manner of Presentation

Companies have been asked to make material information more prominent and de-emphasize less important information. For example, companies have been asked to emphasize how and why they established certain compensation levels and to shorten discussions of compensation program mechanics. The report also stated that additional charts, tables and graphs, not specifically required by the revised rules, were helpful and that careful drafting with plain English principles can result in shorter, more concise and effective disclosures. Where companies use boilerplate disclosure, they have been asked to provide a clear and concise discussion of their own facts and circumstances, and where companies repeat information from the compensation tables in the CD&A, they have been asked to replace the repetitive disclosure with analysis.

A Practical Suggestion

Mr. White ended his speech by making the following practical suggestion for preparing CD&As for the upcoming proxy season: before drafting the CD&A, each key participant in a company's compensation decision-making process should provide, in a one-page bullet point format, what he or she views as the key "hows" and "whys" of compensation decisions, including, as appropriate, discussions of the three key points of analysis discussed above.

We will be discussing the Staff's report, our experience in working with clients in responding to its comment letters, and

other 2008 proxy season compensation related issues at our upcoming General Counsel Forum, on “**Critical Issues for the 2008 Proxy Season: Shareholder ‘Access,’ ‘Say on Pay’ and 2nd**

Generation CD&A Disclosure Issues.” Invitations to the Forum will be issued shortly. For more information on the General Counsel Forum, please contact Wendy Moore at wendy.moore@lw.com.

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