

2009 Proxy Season Update: Why Companies Should Continue to Refine the Compensation Discussion and Analysis

Executive compensation continues to be a hot button issue for regulators, shareholders and the media. Companies would be well advised in 2009 to continue to refine and improve their executive compensation disclosure—and avoid or minimize future issues with SEC reviews and institutional shareholders—by taking into account developing regulatory and investor concerns and anticipating changes in disclosure requirements and expectations. In particular, companies should consider the following when preparing this year's Compensation Discussion and Analysis (CD&A):

- *Performance Targets.* Companies are encouraged to review the disclosure of historical and current year targets, as well as mid-cycle targets in a multiple-year performance period. The US Securities & Exchange Commission (SEC) continues to push for disclosure of actual prior year numerical targets, as opposed to simply describing the types of performance metrics utilized. Disclosure of mid-cycle long term incentive plan (LTIP) targets, although not usually material for prior year's compensation, may in the current environment be appropriate if last year's compensation was affected by performance against such targets. For example, if additional annual compensation was provided because the LTIP awards had become valueless, disclosure of the mid-cycle LTIP targets may be appropriate. Also, the SEC continues to set a high bar for withholding targets based on the potential for competitive harm.
- *Benchmarking.* The SEC has continued to focus on the use of benchmarking in determining executive compensation. Companies that make use of benchmarking should not only identify the applicable peer group, but also adequately explain the reason why the comparative group of companies is appropriate.
- *Compensation Consultants.* Updated SEC guidance has clarified disclosure requirements relating to the role of compensation consultants. Information regarding any role of compensation consultants in determining or recommending the amount or form of executive and director compensation for a company should be provided as part of the company's compensation committee disclosure. If a compensation consultant plays a material role in the company's compensation-setting practices and decisions, then the company should also discuss that role in its CD&A.
- *Analysis.* Companies should continue to review the quality and extent of the analysis in their CD&As. The CD&A should focus on why compensation decisions were made rather than describing the process for how decisions were made. Many companies have made significant changes in their executive pay practices in the past year, and the purpose of these changes should be clearly explained.
- *Risk Analysis.* Risk assessment and certification is a new requirement applicable to certain financial institutions participating in the Troubled Asset Relief Program (TARP). However, SEC Director John White has indicated that all companies should consider the disclosure implications of TARP. Accordingly, even companies that are not subject to TARP should consider whether discussion and analysis of risk and its impact on compensation is appropriate.

- *Year-Over-Year Disclosure.* Most companies will now need to disclose three full years of annual compensation in the Summary Compensation Table. Companies should consider whether their CD&As adequately address trends or changes in the “year-over-year” information presented in this table.
- *SEC Responses and Guidance.* Companies that received comment letters from the SEC should make sure that their current disclosure is consistent with their responses to the SEC. Companies should also take into account the SEC’s most recent guidance reflected in comment letters and updated interpretations made available as this guidance has continued to evolve.
- *RiskMetrics and Other Institutional Shareholder Concerns.* RiskMetrics Group (formerly Institutional Shareholder Services or ISS) has recently updated its corporate governance policies for 2009. Companies should be aware of relevant institutional shareholder policies as they formulate compensation programs and arrangements. With respect to the CD&A, RiskMetrics considers poor disclosure practices to be a poor pay practice that may trigger a withhold or against vote recommendation with respect to compensation committee members, the chief executive officer or possibly the entire board of directors. For additional detail as to what may constitute a “poor pay practice” by RiskMetrics, please refer to our upcoming *Client Alert* on the RiskMetrics guidelines that apply to executive compensation and equity plan proxy matters in 2009.

Members of the Corporate and Benefits and Compensation Practice Groups at Latham & Watkins LLP regularly work with companies preparing their CD&As and have a thorough understanding of regulatory and market practice. Please call any of us if we can be of assistance.

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