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Our SEC Comment Letter on the Executive Compensation Disclosure Proposals

August 18, 2009

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-13-09

Dear Ms. Murphy:

We are pleased to submit this letter in response to Release No. 33-9052. The following suggestions are being submitted relatively early in the comment process to enable the SEC Staff and the Commission to implement—in time for this upcoming proxy season—important changes identified and set forth primarily in the "Other Requests for Comments" section of the Proposing Release at pages 63-65 (pages 35092-3 of the Federal Register version). These suggestions, which address weaknesses in the current disclosure requirements, are particularly timely—and important to implement now—in order to restore integrity to the proxy disclosures and public trust in the disclosures.

Addressing Short-Sighted Risk Taking and Identifying Incentives That Create Long-Term Enterprise Value—Importance of a Hold-Through-Retirement Disclosure

The new proposals regarding risk disclosure in the CD&A appear to many practitioners as not providing enough specific guidance to be meaningful. As a result, there is great risk that most companies' disclosures will fail to address specific, important action items.

A prime example is the need for companies to focus on the encouragement of short-term risk taking (to increase the stock price) that is inherent in most stock option and restricted stock grants. A key disclosure point for shareholders is whether compensation is geared toward short-term gains or long-term value for shareholders.

The final rule should clearly specify that the CD&A includes a discussion that requires the compensation committee to address equity compensation, and the presence or absence of a long-term holding provision for the CEO and top level executives. It is generally recognized now that a hold-through-retirement component is an important provision to address the short-term risk taking vs. long-term value creation concern—and to show shareholders that executives receiving equity grants will focus on long-term enterprise value. (See the July-August 2009 issue of *The Corporate Executive* at pgs 7-8 and see the November-December 2008 issue of *The Corporate Executive* at pg 1.)

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This also applies to large bonuses (and whether a meaningful portion of such bonuses is paid in equity that must be held for the long term). By having a captioned disclosure addressing hold-through-retirement and other long-term provisions such as clawbacks for bonuses based on short-term actions/results that had adverse long-term consequences, shareholders will be able to assess whether a board's compensation practices are fostering a short-sighted risk taking mentality or a "skin in the game" long-term value approach.

Lastly, it should not be overlooked that the hold-through-retirement disclosure requirement should also apply to directors to guard against the same short-sighted risks that can influence executives' decisions. For example, if it is disclosed that a director is required to hold a significant portion of his/her equity grants for the long term, shareholders will be able to ascertain that the directors are focused on ensuring long-term value creation.

Internal Pay Equity—Important Disclosure and Analysis

One significant criticism of the way many boards set executive compensation centers around benchmarking against survey results in order "to be competitive." External comparisons are only one component. Compensation committees must also take into account the impact on employees and other stakeholders where the CEO's compensation has gotten out of line from the company's own historical internal ratios. Over the last 20 years, due largely to increased equity compensation grants and large post-employment provisions, CEO compensation at many companies has gotten out of line from the company's own historic norm. This disparity, in turn, results in lower employee morale and a lack of shareholder trust in management and boards.

The "to be competitive" mantra is not analysis. It is akin to companies that engaged in risky derivative or mortgage transactions justifying their actions by saying "everyone else is doing it and we need to be competitive." Directors must now be held accountable to analyze—and then address—compensation practices that are no longer appropriate. Internal pay equity analysis is a key internal analysis to counter external survey chasing. Internal pay equity analyses can ferret out where and to what extent equity grants were transformed into another form of annual compensation (as opposed to a long-term incentive), and how severance and other post employment "safety net" provisions were implemented without appropriate sunsetting once a CEO's accumulated wealth has reached a point where there is no longer a need for a safety net.

We strongly support the need for a CD&A section addressing internal pay equity analysis. The disclosure should not only provide the findings, but also include a critical *analysis* of the corrective actions considered and implemented. This disclosure will provide shareholders with the kind of information and analysis that is necessary in order to assess a company's compensation policies—and the compensation committee's performance.

To prevent the numbers from being gamed, the analysis must include all components of compensation, including all equity grants and the full walkaway amounts the CEO will receive. Also, to prevent a company from "gaming the ratios" by raising the compensation of the next level of executives, the comparisons should be against several different levels of executives, as well as to the average worker. And, the comparisons should go back historically within the company.

The Need for CD&A Disclosures of Key Analytic Tools Utilized by the Compensation Committee—Including the Resulting Findings and Analysis—and Corrective Actions Considered and Taken

In order for shareholders to be able to assess the performance of directors on the compensation committee and to make an intelligent decision on a say-on-pay vote, it is critical to see the analysis that went into the compensation committee's decisions—and to see whether the compensation committee employed generally accepted analytic tools—and for shareholders to gain insight into the resulting findings and analysis, and corrective actions considered and taken by the directors on the compensation committee.

It is not enough to simply state in the CD&A that the compensation committee considered tally sheets and other tools. The CD&A should specifically address the key tools: tally sheets, internal pay equity analysis and full walkaway/wealth accumulation analysis. Just as with internal pay equity, the CD&A must provide shareholders with the findings, the compensation committee's analysis and corrective actions considered and taken.

The Compensation Committee Report and the CD&A—Accountability

A fundamental problem with CD&A disclosures and analysis has been the question of ownership and accountability for the disclosures. Unfortunately, without clear accountability on the part of the directors on the compensation committee for the content and actions set forth in the CD&A, directors have not scrutinized the disclosures—and particularly the lack of real analysis—in the same way they would if they felt true personal responsibility for the disclosures and knew they would have potential exposure for material misstatements or omissions. As a result, for example, directors are not pressing for the inclusion of meaningful analysis in the CD&A in the same way they would if they were held accountable for these material disclosure omissions.

Shareholders who are trying to ascertain whether to vote for the election of directors—particularly, those on the compensation committee—(and who also will be casting say-on-pay votes) are entitled to know what analysis and actions the directors took. Yet, notwithstanding a multitude of Staff comment letters and various speeches from the Staff, the CD&A (which was hailed by the Staff and the Commission as the cornerstone of the 2006 proxy disclosure amendments) has not lived up to expectations. This is largely due to the accountability gap.

By making the CD&A part of the Compensation Committee Report and requiring that the Report be "filed," we believe that the current flaw in accountability will be rectified—and that shareholders will receive the kind of analysis that the CD&A was intended to provide.

Knowing that your signature is under the CD&A and that your name is "on the line" makes a difference. We expect that some who might want to shield their director clients from responsibility might argue that, since most CD&As are drafted by in-house HR personnel or company counsel, directors should not be accountable. Indeed, this situation has led to a "no accountability zone" where the drafters feel that they are only scribes and the directors are assuming that what the drafters have written complies with the requirements (and thus they can sign off in the current compensation committee report). The way to address this lack of "ownership" is not to say keep it the way it is, but to make the CD&A the Compensation Committee's disclosure.

[Also, the argument that not being "filed' encourages more fulsome disclosure has been proven wrong by the lack of meaningful analysis in CD&As, notwithstanding Staff admonitions at Conferences and in Staff comment letters. Accountability is the key to compliance.]

Drafter Accountability. Although some drafters may claim to be only "scribes," drafters decide on the initial content (and analysis—or lack thereof) and often serve as advisers regarding what is "required" and what should be disclosed/addressed and what the analysis should look like. Some drafters and reviewers have intentionally muddied the CD&A disclosures. Drafters truly are gatekeepers, with attendant responsibility and accountability. An important fix that would place responsibility on those drafting the disclosures—in addition to the directors on the Compensation Committee—would be to add a requirement that the names of the individuals who were the principal drafters of the CD&A be listed under a heading Principal CD&A Drafters in a company filing (*e.g.*, the 10-K).

Ensuring Independence. We believe that such a "name on the line" accountability requirement would serve as an important, effective component of the "independence" requirements being proposed for directors and consultants because having your name on the line would address the inherent conflict faced by anyone who advises directors or executives who feels compelled to sugar coat the guidance for fear of jeopardizing the relationship with the client/employer.

Providing Full Walkaway Numbers

One of the most important proxy disclosure fixes that needs to be in place for this upcoming proxy season can be accomplished without a new rule change. It involves ending a misleading practice that has enabled most drafters and compensation committees to ignore (or intentionally avoid) their principles-based obligation to provide full walkaway numbers in proxy statements and to avoid any attendant analysis. As Treasury Secretary Geithner underscored in his June 10 statement on executive compensation that was coordinated with the SEC, providing the walkaway number is essential in order to analyze the need for—and to assess the compensation committee's justification for—maintaining severance and SERPs and other post-employment "safety nets."

The omission of full walkaway numbers has resulted in misleading disclosures that are only uncovered after the fact when an executive is terminated or leaves the company and the full walkaway amounts are finally disclosed (or ferreted out).

A clear statement in the adopting release that principles-based disclosure requires providing full walkaway numbers and the attendant analysis of the need for safety net provisions where the accumulated amounts may have obviated any need, could suffice for now. For the sake of clarity, however, we believe that in addition to a clear statement from the Staff, there will need to be a specific disclosure requirement in the rule at some point (ideally now) so that drafters and advisers don't use the current dodge of getting around principles-based disclosures by pointing to the rules and saying: "where does it say that in the rules?"

162(m)—Another Key Fix to Address Non-Compliance—That Can Be Accomplished Right Now

The Emergency Economic Stabilization Act of 2008 (the "EESA") and the US Treasury's Capital Purchase Program (the "CPP") has brought the SEC's Section 162(m) disclosure guidance to the forefront again, with a requirement that any participating institution agree, as a condition to participate in the CPP, that it will be subject to the $500,000 annual deduction limit under Section 162(m)(5). Section 162(m)(5), which was added by Section 302 of the EESA, reduces the deduction threshold for the remuneration paid to senior executive officers during any taxable year from $1 million to

$500,000, and it also eliminates the exception to the deduction limit for "performance-based compensation" as well as deferred compensation.

A major disclosure gap has arisen now. A financial institution subject to the $500,000 deductibility limit imposed in the EESA that chooses, nevertheless, to pay more, may (incorrectly) conclude that it does not have to disclose this fact in its proxy statement. The Section 162(m) compliance disclosures provided by participating financial institutions in their proxy statements this past year underscore the problem. Companies are not providing to shareholders the actual amounts paid to NEOs in excess of the caps, disclosing the lost tax deductions or explaining how those amounts—as well as the public's expectations of compliance—have been considered in the compensation committee's analysis and decisions.

We believe that this information is material for all companies, especially given the current economic climate and needs to be disclosed in the CD&A; otherwise, shareholders will have no idea if the boards of their companies are sticking with the applicable restrictions or purposefully exceeding them (at shareholders' additional expense through lost tax deductions). The SEC should make clear that principles-based disclosure requires actual disclosure of any amounts received by each executive that exceeded the deductibility cap, the amount of the foregone tax deduction and an explanation and conclusion that the board considered the issue and nevertheless decided to exceed the deductibility limits. This disclosure requirement should also specify that issuers must make clear that the forgone tax deduction is a real cost to the issuer.

Just as with providing full walk-away numbers and analysis, this disclosure (and tax gross-up disclosure) can be accomplished (even without a specific new rule) by a clear statement from the Staff or the Commission that principles-based disclosure requires providing this material information.

Additional Important Fixes

We also direct the Commission's attention to the fixes enumerated in the attached March-April 2009 Special Supplement to *The Corporate Executive,* and the comments set forth in the attached July-August 2009 issue of *The Corporate Executive,* which we would like to make a part of our comment.

Key Supporting References

Lastly, in further support of the need for having the above changes in place for this year's upcoming proxy statements, we direct the Commission's attention to:

1. The attached Summer 2009 issue of *Proxy Disclosure Updates,* in which former Chief Counsel, David Lynn, and former Special Counsel, Mark Borges, assess the past year's proxy disclosures and conclude on page 13:

   What We Did Not See

   Unfortunately, many disclosures did not contain the critical analysis that the SEC has made clear should be provided in the CD&A. Too often, an explanation of "to be competitive" took the place of real analysis. When use of tally sheets and wealth accumulation and internal pay equity analyses were mentioned, generally there was little or no accompanying discussion of how

they were used, the findings or any resultant actions. Also, it is troublesome that many companies still are not providing the actual amounts paid to the CEO and other NEOs in excess of the Section 162(m) deduction limit.

Further, companies seem to be ignoring (or intentionally avoiding) the need to provide full "walkaway" numbers upon a termination of employment, making the retirement and severance estimates provided in disclosures incomplete and misleading. When shareholders (and compensation committees) do not receive the full walkaway amounts (including accumulated unrealized equity gains and accelerated vesting, etc.), public trust is eroded and "principles-based" disclosure is undermined.

Each of us involved in the process—from those advising boards of directors to those who draft and review the disclosures, to institutional shareholders and regulators—must do our part to address these shortcomings and help restore trust and integrity to the system.

2. The Summer 2009 issue of *Compensation Standards,* which focuses on the Administration's four guiding executive compensation principles and addresses the need (at pgs 4-5) for full walkaway disclosure and other relevant disclosures.

Respectfully,

Jesse M. Brill

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Editor: **David Lynn,** Partner, Morrison & Foerster and former Chief Counsel, SEC Division of Corporation Finance (dave.lynn@thecorporatecounsel.net).

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