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SEC Publishes Its Observations in the Review of Executive Compensation Disclosure

On October 9, 2007, the Securities and Exchange Commission (“SEC”) published its observations upon completing an initial review of the executive compensation and related disclosure of 350 public companies under the SEC’s new and revised rules on executive compensation disclosure (effective November 7, 2006).¹ The goals of the SEC’s review of these companies’ executive compensation disclosure were to evaluate compliance with the revised rules and to guide companies to improve their disclosure. The SEC’s report outlines the most significant comments it provided to companies in the hopes that companies will prepare their disclosure in accordance with the “themes and principles” in the report. This memorandum summarizes the main themes and comments in the SEC’s report.

I. Manner of Presentation

According to Item 402 of Regulation S-K, companies must provide “clear, concise, and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers . . . and directors . . . by any person for all services, rendered in all capacities. . . .” The SEC’s report offers suggestions on improving the presentation of companies’ disclosure in order to comply with Item 402’s requirement. For example, the SEC prefers that a company emphasize material information and de-emphasize less important information, as well as emphasize how and why it determined compensation levels while de-emphasizing and shortening detailed explanations of compensation programs.

A. Format

- The Compensation Discussion and Analysis is intended as a narrative overview of the company’s compensation disclosure and should, therefore, be placed before the required compensation tables.

¹ *Staff Observations in the Review of Executive Compensation Disclosure* (Oct. 9, 2007) available at <http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm>.

- Charts, tables and graphs not specifically required by the revised rules are generally useful. Tables indicating potential payments upon termination or change-in-control should disclose the amounts a company would be required to pay its named executive officers upon termination or change-in-control.
- Companies choosing to include alternative summary compensation tables should de-emphasize the alternative tables and ensure the titles of the tables do not erroneously lead one to assume the tables are part of the required compensation tables. The SEC has asked some companies presenting alternative summary compensation tables to state that the alternative tables do not substitute for the information required by the revised rules, or to explain the differences between compensation amounts presented in the alternative and required tables.

B. Clarity

- It is possible to provide a clear and concise disclosure, as required by the revised rules, while fully complying with the disclosure requirements. When the SEC asks a company to add to or improve its analysis of how and why it made certain executive compensation decisions, the disclosure need not be lengthened. The SEC states: “careful drafting consistent with plain English principles could result in a shorter, more concise and effective discussion that complies with [the] rules.”
- In the Compensation Disclosure and Analysis, companies using a boilerplate disclosure, or quoting verbatim the language of a compensation plan or employment agreement, or simply repeating information listed in the required compensation tables were asked, instead, to articulate their individual “facts and circumstances” and analyze clearly and concisely the information presented.
- Where practicable, companies should increase font size in tables and footnote presentations to enhance readability.

II. Compensation Discussion and Analysis

As part of the revised rules, the SEC adopted the Compensation Discussion and Analysis — a principles-based requirement in which companies gauge their own “facts and circumstances” and determine the material information pertaining to the compensation objectives and policies for their named executive officers, which they must disclose. Companies are expected to discuss their compensation policies and decisions, as well as “analyze the material factors underlying those policies and decisions.” Many of the SEC’s comments to companies highlighted the need to elaborate on how they arrived at certain amounts and forms of compensation and why they pay that compensation.

A. Compensation Philosophies and Decision Mechanics

- Companies explaining their compensation philosophies and decision mechanics in great detail should refocus their presentations on the substance of their compensation decisions, discussing how they analyzed information and why they ultimately reached their compensation decisions.

- Companies should discuss whether and how amounts paid under each compensation element affected the companies' decisions regarding amounts they paid under other compensation elements.

B. Differences in Compensation Policies and Decisions

- Companies are reminded that they should identify material differences in compensation policies and decisions for individual named executive officers.

C. Performance Targets

- Where a company's use of corporate or individual performance targets is material and warrants disclosure, the company should clarify how it analyzed performance and how it used the performance targets to determine compensation policies and make compensation decisions.
- A company not disclosing material performance targets, claiming such disclosure could cause it competitive harm, must "discuss how difficult it will be for the executive or how likely it will be for the company to achieve undisclosed target levels or other factors."
- A company presenting a non-GAAP financial figure as a performance target should disclose how it would calculate that figure.
- Certain situations may require a company to discuss prior and current year performance targets "to place its disclosure in context or affect a fair understanding of a named executive officer's compensation."

D. Benchmarking

- Where a company considers other companies' compensation information in determining its own executives' compensation, and such benchmarking is material, the company must identify the companies and compensation components it used for comparison, and must explain in sufficient detail how it used comparative compensation information and how such information affected compensation decisions.
- Companies employing comparative information but retaining discretion on how to use such information should disclose the "nature and extent" of such discretion.

E. Change-In-Control and Termination Arrangements

- Companies should explain the reasons behind their structure of the material terms and payment provisions in their change-in-control and termination arrangements.
- Companies should disclose how potential payments and benefits under these arrangements affected their other compensation decisions.

III. Corporate Governance

- Companies should be mindful to include complete information regarding which individuals made the compensation decisions. For example, where a principal executive officer participated in the decision-making process, his or her role should be described. Likewise, companies are required to clearly disclose the nature and scope of the role of any compensation consultants used.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Jon Mark at (212) 701-3100 or jmark@cahill.com; John Schuster at (212) 701-3323 or jschuster@cahill.com; or Yafit Cohn at (212) 701-3089 or ycohn@cahill.com.