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A legal update from Dechert's Employee Benefits and Executive Compensation and Corporate and Securities Groups

SEC Provides Guidance on Forthcoming Report on 2007 Executive Compensation Disclosures

In August, the SEC Staff, through a special Task Force within the Division of Corporate Finance, distributed comment letters to 350 public companies regarding their executive compensation disclosures, including the Compensation Discussion & Analysis (CD&A) and tabular disclosure required by Item 402 of Regulation S-K. These comments were previewed in a speech by John White, Director of the Division of Corporate Finance, given to the American Bar Association on August 14, and followed on the heels of updated interpretive guidance published on the SEC's web site on August 8 (www.sec.gov/divisions/corpfin/guidance/execomp402interp.htm). The speech and interpretive guidance were discussed in a prior *DechertOnPoint* update (see [August 2007/Special Alert](#)).

Update on Process

On September 26, Mr. White, in a speech given to the Practicing Law Institute, confirmed that the Staff is conducting a targeted review of executive compensation disclosure in proxies filed under the new rules. (For additional comments on the SEC's executive compensation disclosure rules, see our prior *DechertOnPoint* updates, [August 2006/Issue 46](#) and [February 2006/Issue 43](#).) This is a two-phase process that involves reviewing disclosures from 350 larger companies spread across a broad range of industries. Phase 1 consisted of the issuance of comment letters on the disclosures of those companies involved in the review. The comments consisted primarily of requests for additional information or comments requiring future disclosure. Companies were given 30 days to notify the SEC as to when their responses would

be forthcoming. A give and take of comments and responses would then occur, although a majority of the companies selected had not yet responded to the comment letters.

As issuers satisfy the Staff's requests for additional information and reach agreement with the Staff regarding the implementation of comments in future filings, the letters and responses will be posted to the SEC's EDGAR database (typically 45 days following completion of each applicable issuer's proxy review), and thereafter will be publicly available. As with any proxy review, Mr. White did not foreclose the possibility that amendments to proxy materials previously filed may be required.

Phase 2 will consist of a report issued by the Staff later this year, in time for the next proxy season, on what the Task Force has seen in the course of its reviews of executive compensation disclosure for the 2007 proxy season. The report is intended to provide guidance as to the Staff's expectations for the 2008 proxy season.

Following issuance of the report, the Staff will assess whether additional rulemaking or interpretive guidance is necessary. However, no amendments to the executive compensation disclosure rules will be made in time for the 2008 proxy season.

What to Expect

The report will identify areas for improvement and specify areas where companies have met the Staff's expectations. Specifically, the report will focus on two areas: manner of presentation and the CD&A.

Manner of Presentation

Mr. White indicated that a “plain English” presentation of the CD&A is paramount in the Staff’s view. The Staff expects clear and understandable disclosure that is also responsive to the disclosure requirements. Mr. White indicated three areas to be included in the report:

Better analysis. The Staff believes that companies have made a good faith effort to make their disclosure clear. However, some companies have failed to make sufficient disclosure of the compensation committee’s process, (e.g., how the committee utilizes benchmarking data, establishes performance targets, and varies compensation among named executive officers (NEOs)). The Staff will be looking for better analysis, while adhering to concise and easy to understand language.

Consistent format. The format of disclosure was consistent in most cases, but, where a company’s disclosures are presented in a different format, the Staff will look to see if the deviation affects readability and content. The Staff has indicated that supplemental charts, tables, and graphs provided by issuers in the executive compensation disclosure section were generally helpful.

Alternative summary compensation tables. Several issuers have included secondary summary compensation tables. Although some of the alternative tables were helpful, others were confusing. The Staff will ask companies to de-emphasize alternative tables unless they are helpful to a reader’s understanding of a company’s executive compensation.

CD&A Comments

Mr. White indicated that the Staff intended a clearer and more complete picture of executive compensation. For the most part, companies provided extensive discussion of the elements of executive compensation, but fell short in analyzing these elements. Mr. White indicated four areas to be included in the report:

Performance targets. This is the area that received the most comments from the Staff. The report will note that there is no *per se* line item requirement for performance targets and that a company’s targets are required to be disclosed only if material. In the com-

ment letters, the Staff asked questions if a company disclosed targets and assumed that undisclosed targets were not material. The report will note that, where individual targets are used, the Staff expects companies to provide analysis of how such targets were chosen. If a company does not disclose targets, on the basis that disclosure would result in competitive harm (based on the FOIA standard for non-disclosure of confidential information), then the Staff will require alternative disclosure as to the likelihood of attaining the relevant target. Summary disclosure (e.g., “attaining the performance target is very difficult”) will not be permitted.

Time period to disclose performance targets. The normal time period covered by the CD&A is only the last fiscal year. However, the SEC clarified in its adopting release that performance targets for other years (including the then-current year) must be disclosed if material to an investor’s understanding of an NEO’s compensation for the last fiscal year. Mr. White cited as an example a multi-year agreement with performance targets that change year-to-year.

Material compensation differences among NEOs. The Staff has noted a lack of explanatory information regarding compensation differences among NEOs, even when the tabular information indicates that such differences exist. Accordingly, the Staff will be looking for additional explanatory disclosure as to why NEOs are paid differently and an analysis of the compensation committee’s rationale for setting varying compensation levels.

Benchmarks. The Staff will expect companies that benchmark executive compensation against other companies to identify, where material, the benchmark companies, how the issuer used the comparative information, and how decision-making was affected.

Overall, Mr. White indicated that the report will express that the Staff is pleased with the additional disclosures, especially in the areas of perquisites, description of the elements of compensation, the ability to assess accumulated wealth, director compensation, and information about the compensation committee. The report will also indicate that there is room for improvement, especially in those areas highlighted above.

What to Do

It is not too early to begin reviewing the comment letters, responses, and Staff report (as they become available) to anticipate the changes in executive compensation disclosure to be made to your company's 2008 proxy statement. Advance planning will save

time later and allow your company to modify its compensation processes in a manner responsive to the Staff's comments. This is particularly important to consider prior to making critical year-end compensation decisions regarding bonuses, equity, or other performance grants.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/corporateandsecurities or www.dechert.com/employeebenefits.

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