

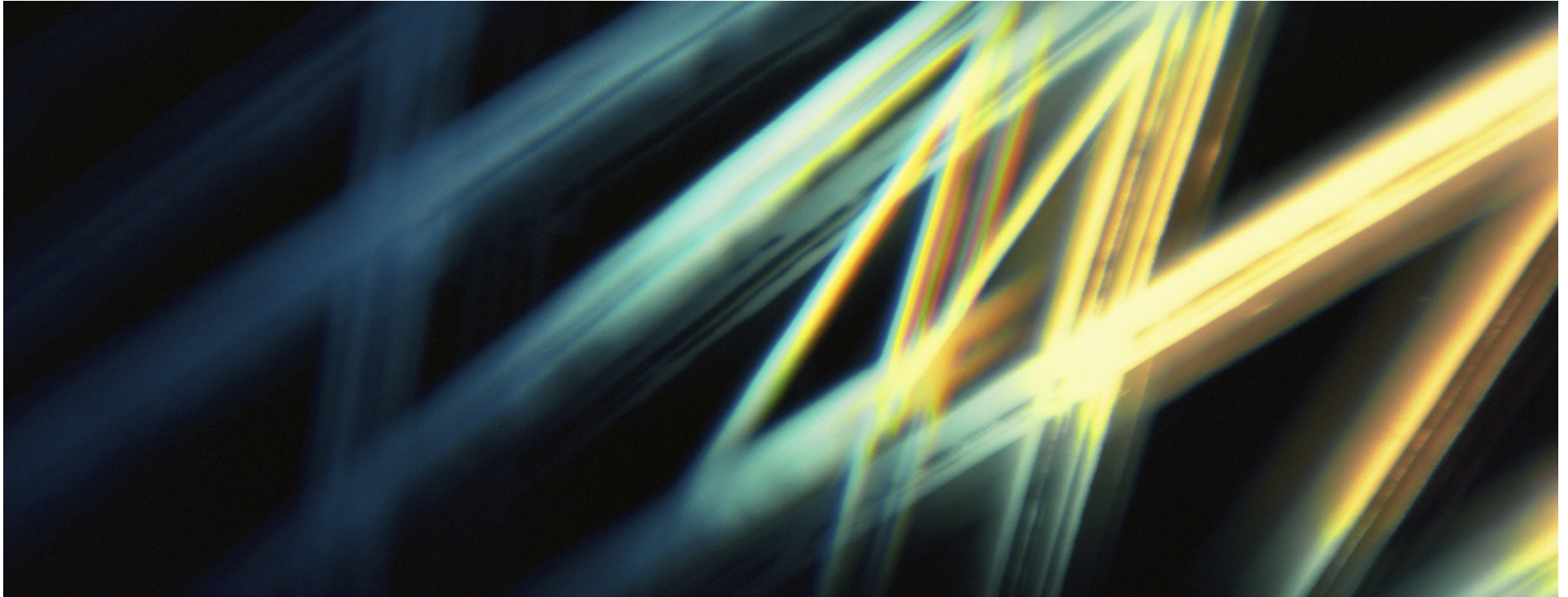
## 2008 Proxy Disclosure – Getting Ready for Round 2

November 15, 2007

Milwaukee Area Compensation Association

## Overview

- Overview of Proxy Disclosure Changes
- 2007 Proxy Season – Looking Back
- SEC Comment Letters
- SEC John White's Speech and Focus for 2008
- Questions



# Overview of Proxy Disclosure Changes

## Overview of Proxy Disclosure Changes

- In 2007, the Securities and Exchange Commission (SEC) made substantial revisions to the proxy disclosure requirements in order to provide greater transparency to public company investors
- Major changes included:
  - Changes to the Summary Compensation Table
  - Long-Term Incentive Tables
  - Expansion of Pension / Deferred Comp Disclosure
  - Detailed Termination or Change In Control Scenarios
  - Director Compensation Table
  - The introduction of the Compensation Discussion & Analysis (CD&A)

## Summary Compensation Table

- New / changed columns:
  - “Total compensation” – Sum of all columns in the table
  - \$ value of stock awards using same valuation method as reported in the financial statement
  - “All other compensation” – Any item of compensation that does not fall into any other category on the table. (Note: Items must be listed if amount exceeds \$10,000)
- Supplemental Table:
  - Grants of Plan-Based Awards Table – Discloses grant date fair value of all stock awards & stock options to the NEOs.
- Additional Tables:
  - Outstanding Equity Awards at Fiscal Year End
  - Option Exercises and Stock Vested

## Retirement Benefits Disclosure

- New Tables:
  - Pension Benefits Table – The actuarial present value of each NEO's accumulated pension benefit on a plan-by-plan basis.
    - Annual benefit payable at normal retirement age and early retirement age
    - Narrative description which may include the lump sum distribution payable at the end of last fiscal year, as well as what pay elements are included in the calculation
  - Nonqualified Deferred Compensation – Discloses contributions, aggregate earnings/withdrawals and year end balances for the fiscal year

## Termination and Change in Control Payments

- Narrative disclosure required for each contract, plan or arrangement for each Named Executive Officer upon termination of employment, change in responsibilities or a change in control of the company.
  - Description of triggers
  - Estimated payouts and benefits
  - Covenants (noncompetition, etc.)
- Potential payments in connection with any termination or change in control
  - Description and quantification of estimated payout and benefits to each NEO
  - Payout estimates are to assume that the CIC triggering event took place on last day of company's last fiscal year.
- Many companies used tally sheets to review this information and presented the data via tables

## Director Compensation Table

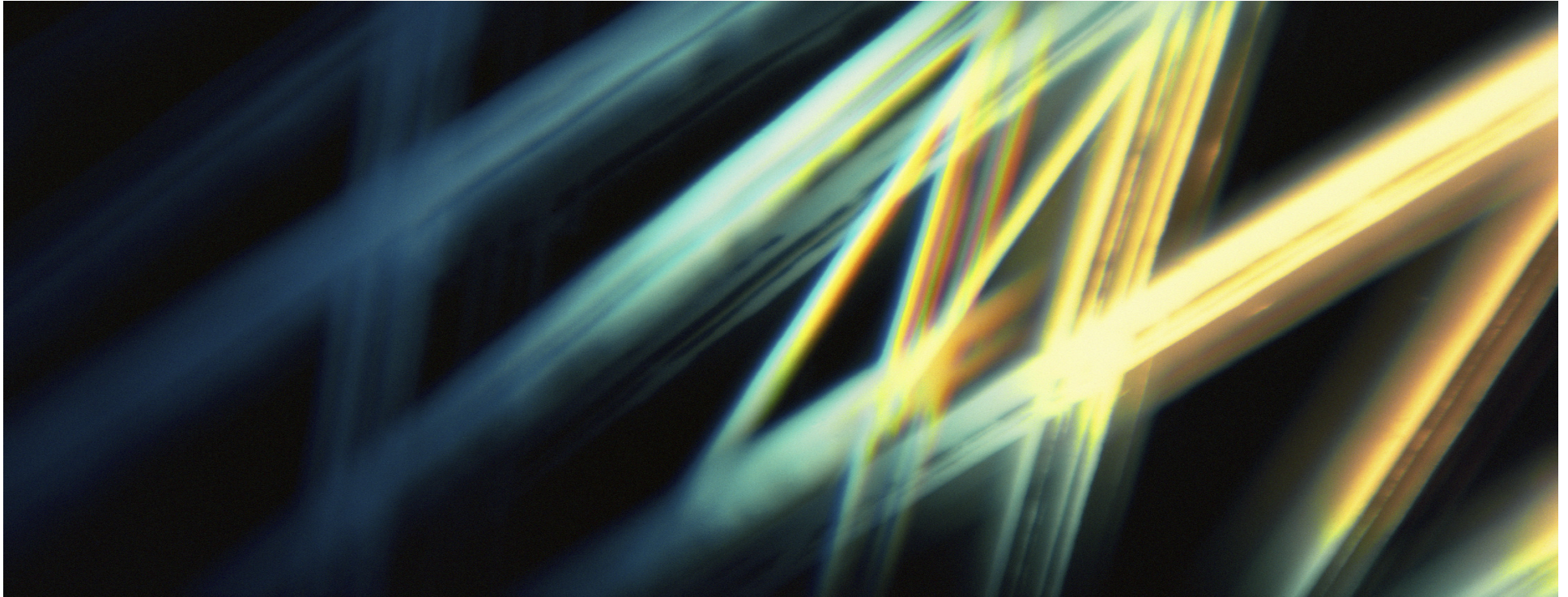
- Similar to the summary compensation table for executive officers
  - Only shows compensation for the prior year
  - Required to provide all director fees whether paid in cash or equity
  - Includes a total compensation column and all other compensation table

## Purpose and Status of The CD&A

- The CD&A is intended to provide a general overview of the material factors underlying compensation policies and decisions.
  - Should precede the tabular disclosures
- The purpose is not to repeat the more detailed information that would follow in the tabular disclosures and accompanying footnotes.
- Unlike the Compensation Committee Report it replaced, the CD&A is “filed” for purposes of the proxy rules and covered by the CEO and CFO certifications required by the Sarbanes-Oxley Act of 2002.

## Questions to be Addressed by the CD&A

- The Company is required to explain all elements of compensation of named executive officers, including responses to the following specific questions:
  - What are the compensation programs' objectives?
  - What are they designed to reward?
  - What are the compensation elements?
  - Why did the company choose each element?
  - How is the amount of each element determined?
  - How does each element fit into the overall compensation objectives?
- The CD&A must address compensation awarded in the last fiscal year
  - May also address actions taken after conclusion of fiscal year (ie., pay decisions, program changes, etc.)



## 2007 Proxy Season – Looking Back

## US Companies' Experience

- US companies grappled with the conflict inherent in:
  - Summarizing material components of NEO pay packages in plain English, while;
  - Addressing all the relevant items, some of which had never been subject to disclosure (ie., retirement benefits, severance arrangements)
- Drafting 2007 proxies was an enormous task
  - No roadmap from prior year
  - Shifting best practices as each new 2007 proxy was filed
  - Vague directions from the SEC (“what is it they want to see?”)

## SEC Reactions to 2007 Proxy Disclosures

- CD&As were disappointing
  - Filings were too long and not written in “plain English”
  - Companies “answered the who, what, where & when, but not how & why” (more analysis desired in 2008)
- Many companies skirted the issue of disclosing performance targets in their STI and LTI plans
  - SEC has said this will be an area of focus in the future
- The SEC was pleased with the expanded perquisites information required under the lower \$10,000 reporting threshold
- More discussion of the CEO’s role in the compensation process is desired

## SEC Reactions to 2007 Proxy Disclosures

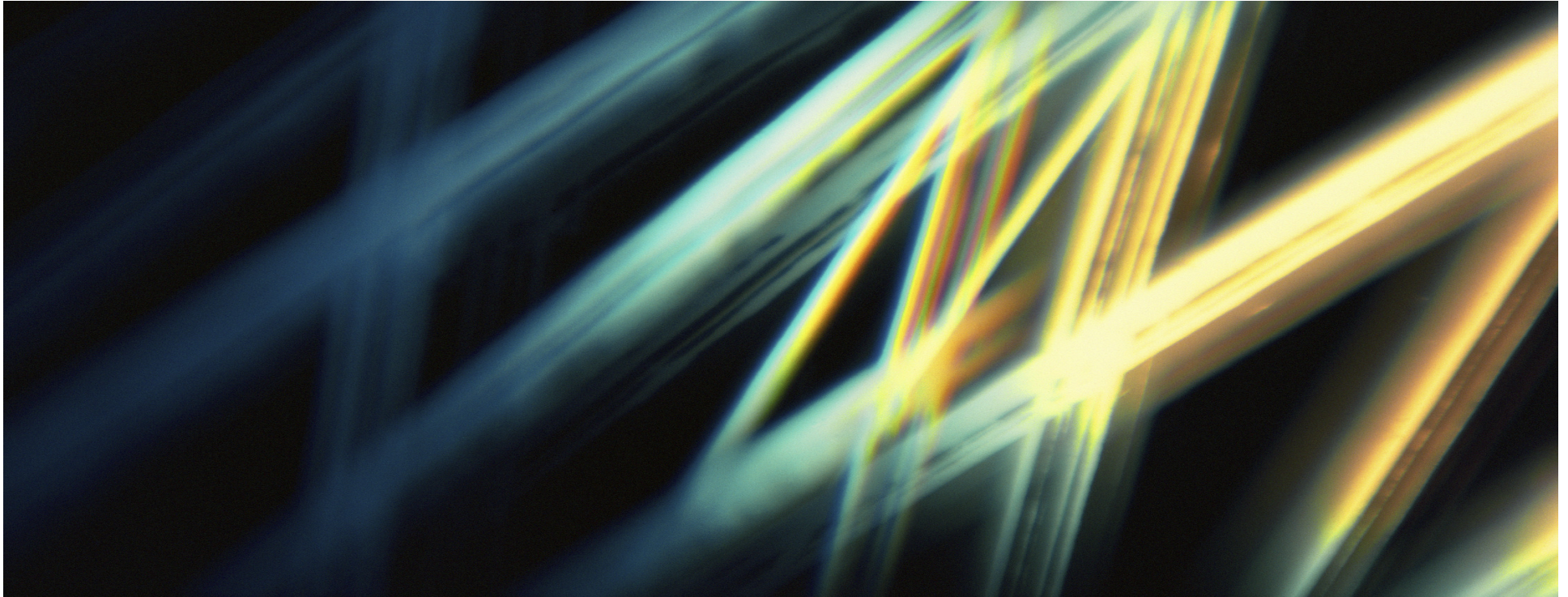
- Initial SEC reaction to first year of “new” proxy filings (per Chairman Christopher Cox)
  - Length of CD&As was much greater than expected
    - “We had it in mind that they would be just a few pages long, but the median length for the CD&As was 5,472 words – over 1,000 words more than the U.S. Constitution”
  - However, the first year of CD&As required all companies to provide background on topics that had never been discussed in detail and are not simple in nature (ie., retirement benefits, severance arrangements)
    - Hay expects CD&As and entire proxies to slowly shrink back from 2007 sizes over the next few years as the SEC and investors respond to the information deluge of 2007

## SEC Reactions to 2007 Proxy Disclosures

- Initial SEC reaction to first year of “new” proxy filings (per Chairman Christopher Cox) (cont’d)
  - Readability of proxy disclosures did not improve (lack of “plain English”)
    - Intent of new rules was to “break down in plain English all the legalese, jargon, and the dense cover-your-assets boilerplate that reads more like the insurance policy it is than the helpful guide to investors that it’s meant to be”
  - The SEC’s use of the Gunning Fog Index to measure proxy readability is creating a lot of discussion
    - Expect companies to use this readability test and others like it next year to assess their achievement of “plain English” disclosure (new step in the CD&A process for 2008)

## 2007 Proxy Disclosures

- Varied practices across this year's proxy filings on:
  - Disclosure and level of detail around financial performance goals
    - Hay believes that U.S. companies will continue to feel pressure from the SEC and shareholder advocates to disclose goals
  - Discussion of peer groups and selection criteria
    - We expect to see more companies outline specific peer group criteria to enable investors to understand each company's inclusion, especially where incentive payouts are determined by relative performance against a peer group



# SEC Comment Letters

## Overview of SEC Comment Letters

- On August 21, 2007 the SEC sent comment letters to several companies
  - Reportedly over 300
  - Letters averaged 10-15 comments
- Companies receiving comment letters needed to respond by Sept. 21
  - Could request an extension if necessary
  - Responses will be available on the SEC website later this year
- The disclosure topic receiving the most comments was performance targets

## SEC Comment Letters

- Performance Targets
  - Companies were requested to disclose their performance targets and if they did not, to provide an explanation for the nondisclosure
    - Companies' interpretation of competitive harm appears to be different than that of the SEC's
  - Discuss weight given to each performance factor
- Individual Performance
  - More detail on how individual performance is taken into account for the NEOs
  - The effect on each individual compensation element

## SEC Comment Letters

- Benchmarking
  - More disclosure of the targeted percentile of survey data and an explanation of why the percentile was selected
  - Disclosure of actual amounts compared to target amounts
  - Disclosure of the names of the peer group companies
- Role of Compensation Consultant
  - More detail on the role of the compensation consultant,
    - Does that person perform other services?
    - Benchmarking only, incentive design, reporting relationship
  - Disclosure of the scope of the consultant's work and instructions given by the Compensation Committee

## SEC Comment Letters

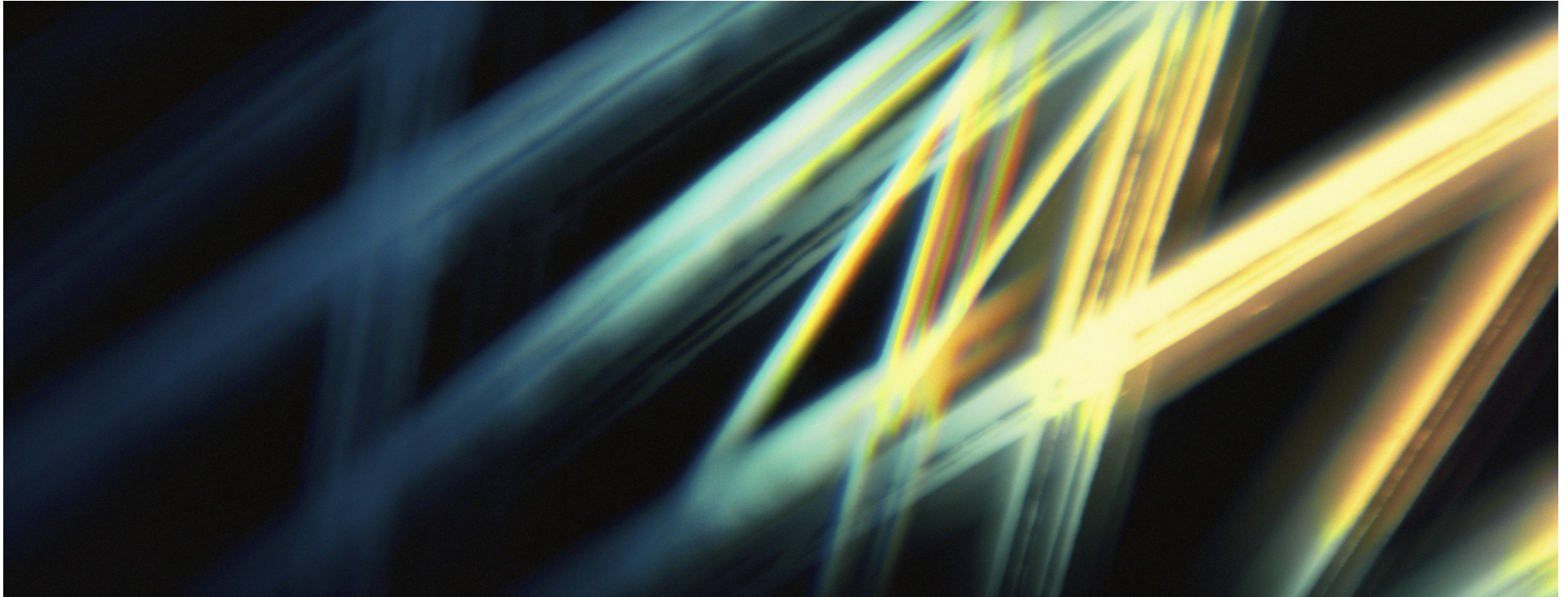
- Role of CEO
  - Details regarding the role of the CEO in the compensation process
  - SEC is concerned that the CEO role might have undue influence over their own compensation
- Differences in NEO Compensation
  - Explanation of the reasons for the differences in compensation awarded to the NEOs
  - Particular focus on why CEO comp is significantly higher than other NEOs

## SEC Comment Letters

- Severance and Change in Control
  - More information on the rationale for establishing termination, severance and CIC packages
  - Investors, media and other stakeholders have expressed concern over these arrangements
    - O’Neal – Merrill Lynch
    - Prince – Citigroup
    - Nardelli – Home Depot
  - SEC wants amount and rationale to be clear
- Annual Incentive Compensation
  - If the company mentioned discretion in determining awards companies were asked to describe if they exercised discretion

## SEC Comment Letters

- Analysis of Elements of Compensation
  - Companies were asked to explain in greater detail why the company chose to pay each element
  - Expand on analysis of the element and level of compensation



# SEC John White's Speech & Focus for 2008

# SEC Observations



U.S. Securities and Exchange Commission

## Staff Observations in the Review of Executive Compensation Disclosure

Division of Corporation Finance

### Executive Summary

The Division of Corporation Finance has completed its initial review of the executive compensation and related disclosure of 350 public companies under the Securities and Exchange Commission's new and revised rules relating to executive compensation disclosure. Two principal themes emerge from our reviews and our individualized comments to these companies.

First, the Compensation Discussion and Analysis needs to be focused on *how* and *why* a company arrives at specific executive compensation decisions and policies. This does not mean that disclosure needs to be longer or more technical; indeed shorter, crisper, and clearer would often be better. The focus should be on helping the reader understand the basis and the context for granting different types and amounts of executive compensation.

Second, the manner of presentation matters — in particular, using plain English and organizing tabular and graphical information in a way that helps the reader understand a company's disclosure. The executive compensation rules require companies to disclose a great deal of information. Techniques such as providing an executive summary, or creating tables or charts tailored to a company's particular executive compensation program, can make the disclosure more useful and meaningful. We encourage companies to continue thinking about how executive compensation information — from the big picture to the details — can be better organized and presented for both the lay reader and the professional.

### Introduction

The Securities and Exchange Commission's new and revised rules relating to executive compensation disclosure became effective on November 7, 2006. These rules have significantly changed the disclosure a public company provides about how it compensates its most highly paid executive officers, including its principal executive officer and its principal financial officer, and its directors. On December 22, 2006, the Commission further amended the disclosure requirements for executive and director compensation with respect to how a public company discloses stock and option award compensation. The revised rules also update and clarify the related person transaction disclosure requirements and consolidate and add corporate governance disclosure requirements.

In the Division of Corporation Finance's regular review of public company current and periodic reports, we routinely provide comments to companies in which we seek clarification of current disclosure or additional information so we may better understand why a company made a particular disclosure. In some instances, we may ask a company to revise or enhance its disclosure by amending the document in which it has provided it. In other instances, we may ask a company to revise or enhance its disclosure in future filings.

In 2007, we undertook a project to review the executive compensation and other related disclosure of 350 public companies to evaluate compliance with the revised rules and provide guidance on how those companies could improve their disclosure. In identifying 350 companies for review, we sought to cover a broad range of industries. No one should interpret our selection of any company for review as part of this project as any indication of our views regarding the quality of that company's disclosure.



U.S. Securities and Exchange Commission

## Speech by SEC Staff: Where's the Analysis?

by John W. White  
Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission

Tackling Your 2008 Compensation Disclosures:  
The 2nd Annual Proxy Disclosure Conference  
San Francisco, California

October 9, 2007

Good afternoon. Thank you Jesse [Brill]. I am excited to return to San Francisco to talk about executive compensation disclosure in the 2007 proxy season — the first season under the new requirements the Commission adopted just over a year ago. The staff's observations on the first year disclosures were published this morning, and what a great forum this is to reflect on where we are in our pursuit of the "clearer and more complete picture of compensation" that the Commission sought in adopting the new rules.

In the next half hour, I plan to share with you some of my views on where the first-year disclosures have realized this goal and where they have not. The positives are substantial — and there is a wealth of new information available to investors for the first time. Investors have been provided with the most comprehensive disclosure ever regarding how much public companies pay their executives and directors. There are some very important areas, however, where work remains for next year.

As I noted, these are my views — so let me go ahead and provide you the required disclaimer — the views that I'm going to express today are solely my own and do not necessarily reflect the views of the Securities and Exchange Commission or of any members of the Commission or its staff, other than myself.

It was in this city, at this series of conferences, three years ago in 2004, that my predecessor Alan Beller started it all off with his memorable "all means all" speech. We have come a long way since then — 382 pages of proposals, almost 30,000 comment letters, 489 pages of adopting releases, 112 interpretations, a first full season of disclosures and, most recently, a staff report on the first year disclosures after 350 reviews.<sup>1</sup> On Alan's "all means all" point, we have made great progress — the rules are pretty clear on what compensation companies need to disclose, and what they need to quantify. The new tables and footnotes, and what companies are required to put in them, take us a long way toward our disclosure goals in this area.

The Commission made clear in adopting the new rules, however, that it is looking for more than just the value of the components of compensation and a total value of compensation. What is that "more" it is looking for? In order to provide investors with more than just tables of numbers, the Commission created the new Compensation Discussion and Analysis requirement to "put into perspective for investors the numbers and narrative that follow it." This "overview" is very much a principles-based requirement, like the MD&A section with which we are all so familiar. In an instruction to the CD&A requirement, the Commission made clear that CD&A "should focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to the analysis of those policies and decisions." My emphasis on the word "analysis" should provide you with a pretty good idea of the principal place where I believe many companies came up short — where disclosure can be improved. More on that in just a moment.

# John White's Speech

John White, SEC Corporate Finance Director

Questions to ask yourself:

- What is material to my shareholders, to my investors, as they examine the compensation of our executives and make their voting decisions for our board of directors and investment decisions with respect to our company?
- What are the material elements of individual executive and corporate performance that are considered in setting executive compensation?
- What is the relationship between the objectives of our compensation program and the different elements of compensation?
- What are the material factors that relate to our compensation decision-making process?

# John White's Speech

## John White, SEC Corporate Finance Director

Then, sit down and focus on two very important aspects of your disclosure:

- Analysis
  - How and why you reached compensation decisions
  - Discuss and analyze, not a laundry list of facts
- Presentation
  - Clear, concise, understandable
  - Tables and charts for complex information

## 2008 Proxy Drafting

“Don’t let coming year’s disclosure be just a mark-up of the first year” (John White)

- Focus on Analysis – The how and why
- Presentation Matters – How a company provides information, in many ways, is as important as the content
  - Facilitates more informed investing and voting
  - SEC Chairman Cox particularly focused on clearer, more concise presentation of executive and director compensation
- Plain English principles still apply to the CD&A
  - Remove redundancies – If table discloses information, don’t repeat it in the narrative
  - Don’t simply copy technical language from an employee agreement or compensation plan
- What investors need or want to know
  - Guide disclosure from a company perspective
- Disclosures only when “material”

## 2008 Proxy Drafting

- Document compensation decisions throughout the year
  - Rationale for decisions, especially those decisions that deviate from the compensation philosophy
- Start early so that there is sufficient time to vet all compensation issues
- Create a project team that includes all key inputs (e.g. HR, Legal, Finance, Compensation Committee, Investor Relations)
- Educate each other or engage outside resources – Every member of the team needs to understand the requirements
- Meet regularly

## 2008 Proxy Drafting

- John White: Ask every key participant to submit a one-page bullet point summary of “analysis
- Draft the proxy – We find that only after the parties actually commence this process do they realize how much is involved
  - Prepare draft disclosure tables for reference
  - Take a step back and be sure the CD&A serves the stated purpose
  - Remember that CD&A is a communication to the company’s owners

## 2008 Proxy Drafting

- Take into account SEC comments when drafting this year's proxy, but focus on your company's particular facts and circumstances
- Step back and review the disclosures and organization
  - Have someone not part of the team read the proxy
  - Does the CD&A describe the story? (Plain English with analysis)
  - Can investors determine compensation levels and thought process for those levels?

Questions?



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