

Preparing Your Executive Compensation Disclosure for Say on Pay

In a few short weeks, companies will begin preparing their proxy materials for their 2011 annual meetings of shareholders. While normally a routine task, this year's preparations will be complicated by two significant new requirements imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act. As we now know, at each annual meeting of shareholders occurring after January 21, 2011, companies must conduct:

- a shareholder advisory vote to approve the compensation of their executive officers, as disclosed in the proxy materials for the annual meeting of shareholders (the "Say on Pay Vote"); and

- a shareholder advisory vote to determine whether subsequent Say on Pay Votes will be held annually, biennially, or triennially.

While the result of these votes are not binding on companies and their boards of directors, clearly they will shape the perception of your company by shareholders, employees, and the public, as well as the reputations of your directors – particularly the members of your board compensation committee. Consequently, this initial Say on Pay Vote will be critical as it will establish the tone for your subsequent votes.

In 2011, the key to a favorable vote will be the quality – and clarity – of the executive compensation disclosure in your

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A Timely Teleconference to Help You Prepare for the New Shareholder Advisory Vote on Executive Compensation

JOIN US ON TUESDAY, NOVEMBER 9, 2010 from 1:00–2:00 p.m. (PT) for a discussion of how to prepare your executive compensation disclosure for next year's initial shareholder advisory vote on your executive compensation program.

This one-hour program will cover the following topics:

- ▶ Drafting an effective –and concise – Executive Summary for your CD&A
- ▶ Highlighting your program strengths, and explaining your weaknesses
- ▶ Discussing your incentive compensation arrangements and equity awards – what's important (and what's not)
- ▶ Streamlining your CD&A – how to say more with less
- ▶ Preparing clear compensation tables
- ▶ Explaining post-employment compensation – how to take advantage of the exception to the shareholder advisory vote on change-in-control arrangements
- ▶ The frequency of the Say on Pay vote – what should you recommend to your shareholders?

Numerous disclosure examples will be provided, as well as our new Say on Pay disclosure checklist

[For further information »](#)

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proxy materials, particularly the Compensation Discussion and Analysis. While, as in previous years, this will involve ensuring that the description and analysis of your executive compensation actions and decisions for the last completed fiscal year are complete and concise, there are several additional disclosure enhancements that warrant consideration as well, including the following.

Use an Executive Summary

We expect that, as a practical matter, the Compensation Discussion and Analysis will serve as the “supporting statement” for your Say on Pay Vote. Consequently, it will be important to reevaluate your current CD&A in light of its new function as a shareholder communication, rather than a regulatory compliance, piece.

In this regard, we believe that it will be important to start your CD&A with a concise statement of the key compensation actions and decisions from the last completed fiscal year involving your named executive officers. In our view, an Executive Summary should include each of the following elements:

- A concise statement of the relationship between your company’s financial performance and the compensation paid to your executive officers. Typically, this will involve a summary of your company’s business results for the last completed fiscal year and an explanation of how these results translated into the compensation actions and decisions for your senior executive officers;
- A summary of the key compensation actions and decisions involving your company’s chief executive officer, accompanied by highlights of his or her key accomplishments for the last completed fiscal year; and
- A description of any significant compensation policies and practices that have been implemented or revised since the last annual meeting of shareholders:

To simplify this presentation, we recommend that you determine whether some of this information can be presented in graphic, rather than narrative, form.

Continue to Address Compensation-Related Risk

While, during the 2010 proxy season, few, if any, companies disclosed that their compensation programs gave rise

to risks that could have a material adverse effect on their business, the SEC Staff’s tendency to issue comments where no compensation-related risk disclosure was provided prompted many companies to discuss their risk assessment and how they monitor and manage compensation-related risk as part of their executive compensation disclosure. Given the continued interest of investors in the risks posed by many compensation arrangements, we expect this trend to continue in 2011.

Consequently, we believe that, in addition to conducting the requisite assessment of your executive compensation policies and practices, you should be prepared to discuss this assessment, and any related subjects, in your executive compensation disclosure. At a minimum, this discussion should include a summary of the key aspects of your program that create potential risk, how risk was evaluated in the course of the compensation-setting process, and the steps that the company has taken to manage or mitigate these risks. In addition, it will be important to highlight the presence of this risk disclosure in the Executive Summary to your CD&A, with a cross-reference to the location of the full discussion elsewhere in your proxy statement.

Simplify Your Incentive Compensation Discussion

In deciding whether to support your Say on Pay resolution, most shareholders will focus on the alignment of executive pay with their long-term interests. Thus, the centerpiece of your CD&A should be the analysis of your annual and long-term incentive compensation plans and arrangements.

As is currently the case, the challenge here will be to explain your incentive plans and arrangements in a clear and concise manner. In our view, there are two guiding principles that should govern this disclosure. First, consider shortening – or dispensing altogether with – the often “boilerplate” description of the process that your company uses in setting the key terms of your incentive compensation awards. Much of this information can be integrated into the overall description of your compensation-setting process in your CD&A. In addition, consider presenting the key information about your incentive compensation awards (such as target award levels, performance measures, target performance levels, actual performance results, and actual award determinations) in tabular, rather than narrative, form. Not only will this make the information easier to locate and

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understand, it will also shorten the length of this portion of your CD&A.

Don't Camouflage Controversial Pay Practices

For some companies, Say on Pay will serve as an opportunity to address any lingering concerns about their executive compensation program. Consequently, we expect that many board compensation committees will take a hard look at any of their compensation policies and practices that may be objectionable to their shareholders or the major proxy advisory firms to decide whether they are prepared to defend these policies and practices, or whether any changes are warranted.

To the extent that this self-evaluation results in changes, you will be well-served to highlight these changes in the Executive Summary to your CD&A as an inducement to shareholders in making their Say on Pay vote decision. In addition, if you have previously updated your executive compensation program, be sure to highlight any "shareholder-friendly" features so that you can receive credit for those provisions in connection with the analysis of your pay program.

Finally, you should consider being candid about any "problematic" pay policies or practices that are part of your executive compensation program. In the new Say on Pay environment, there's clearly no benefit to trying to soft-peddle or bury a controversial item. Where the board compensation committee has determined that a specific policy or practice is reasonable or appropriate for your company, it's important to present your strongest case as part of your disclosure. Depending on the nature of the policy or practice, it may be appropriate to address this matter in the Executive Summary to your CD&A to ensure that it receives the attention of your intended audience.

Thoroughly Discuss Your Severance and Change-in-Control Arrangements

In the new Say on Pay environment, the discussion of your post-employment compensation arrangements, whether they involve retirement plans or severance and change-in-control arrangements, will garner closer scrutiny for two reasons. First, many investors view severance and similar arrangements as an area that is ripe for "pay-for-nonperformance." Thus, it will be important to ensure that the discus-

sion in your CD&A contains a thorough explanation of the reasons for these arrangements and how they further an important corporate objective.

A common problem with many current disclosures is that they simply describe the terms and conditions of the existing arrangements – and don't necessarily explain why the company provides them. Going forward, it will be important for your disclosure to emphasize how your board compensation committee determines the amounts payable to your named executive officers, as well as how these arrangements fit into your overall executive compensation program and affect decisions regarding other pay components.

In addition, since the new Dodd-Frank Act requirement for a separate shareholder advisory vote on executive change-in-control arrangements in the event of a merger or acquisition does not apply where these arrangements have previously been subject to a Say on Pay Vote, we believe that many companies will seek to take advantage of this exception. This development is likely to have two effects.

First, we expect that the disclosure in the Potential Payments Upon Termination or Change In Control section of your proxy statement will receive greater scrutiny as shareholders come to view the Say on Pay Vote as their sole opportunity to register their views on your company's change-in-control arrangements. In fact, this information may become the singular focus of some shareholders, who, in spite of their concurrence with your overall executive compensation program, may cast a negative vote to register an objection to your post-employment compensation practices.

We also expect to see companies expand the descriptions of their change-in-control arrangements in their proxy statements to ensure that they can take advantage of the exception to the shareholder advisory vote on executive change-in-control arrangements. Thus, contrary the emerging trend to shorten your CD&A and related tabular disclosure, this may be one area where the disclosure provided actually gets longer as companies provide comprehensive descriptions of the payments and benefits that their executive officers may receive in the event of a change in control of the company.

Final Observations

While companies will understandably be focused on preparing their executive compensation disclosure for the Say

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on Pay Vote, it's important to remember that the Dodd-Frank Act contains several other executive compensation provisions, most of which will not be effective until the 2012 proxy season. Consequently, even though it may not be necessary to address the disclosure issues presented by these additional provisions in your 2011 proxy materials, you should prepare your disclosure with an eye towards how these items will fit in once they become required. Several of these items, such as the mandatory compensation recovery ("clawback") policy and the "pay-versus-performance" and "CEO-employee pay ratio" disclosures will certainly have a significant impact on future Say on Pay Votes.

Need Assistance?

Compensia has extensive experience in helping companies draft the executive compensation disclosure in the proxy materials for their annual meetings of shareholders and analyze the potential impact on the Dodd-Frank Act executive compensation provisions on their pay programs. If you would like assistance in preparing your executive compensation disclosure for the new required shareholder advisory vote on executive compensation, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Mark A. Borges. ■

About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

San Francisco

770 Tamalpais Drive
Suite 207
Corte Madera, CA 94925
415.462.2990

Mark H. Edwards, Chairman
medwards@compensia.com
415.462.2985

Michael Benkowitz
mbenkowitz@compensia.com
415.462.2996

Mark A. Borges
mborges@compensia.com
415.462.2995

Southern California

Anna-Lisa Espinoza
alespinoza@compensia.com
858.509.1179

Mathew T. Quarles
mquarles@compensia.com
323.919.7338

Silicon Valley

1731 Technology Drive
Suite 810
San Jose, CA 95110
408.876.4025

Timothy J. Sparks, President
tsparks@compensia.com
408.876.4024

Thomas G. Brown
tbrown@compensia.com
408.876.4023

Susan Gellen
sgellen@compensia.com
408.907.4302

Tom LaWer
tlawer@compensia.com
408.907.4309