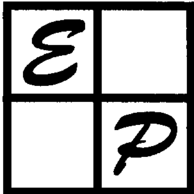

THE CORPORATE COUNSEL

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HIGHLIGHTS AND PITFALLS

The SEC's Proxy Proposals—Comments and Critical Fixes

As promised, we are devoting this issue of *The Corporate Counsel* to important comments and fixes to the SEC's executive compensation proxy proposals (Rel. No. 33-8655, January 27, 2006). Our overall comment: we like the thrust of the SEC's proposals—to make sure that all CEO compensation is, in fact, put on the table and disclosed. We also laud the SEC for the huge effort the Staff has put into these proposals—and the Staff's sincere commitment to getting it right. Our overarching concern, however, is that unless a few critical fixes are made, the rules will fall far short of their potential.

The CD&A: Tremendous Potential If...

We recognize that the current compensation committee report has been a big disappointment. The Staff believes (and we agree) that an important fix here is to make the discussion of compensation a "filed" document—putting the onus now on the CEO (via SOX Section 302 certification) to make sure that all of his/her compensation is fully disclosed and explained. But that, alone, will not do the trick. We believe the following are perhaps the two most critical fixes in the entire scheme of things.

Signatures

There is nothing like putting your name on the line to keep you focused. Professor Jeffrey Gordon, the author of the law journal article advocating a CD&A approach (which was cited in the SEC's proposing release and which we have posted on CompensationStandards.com) had directors' signatures as going to the heart of his proposal to bring accountability and "ownership" of the report to the directors. [See, in particular, Professor Gordon's rationale for signatures, which we have excerpted (including his important footnote 66) and posted separately, on CompensationStandards.com.]

We feel very strongly that the report must be signed by the directors. Otherwise, as it stands, at many companies the CD&A will simply turn into a *management's* discussion of compensation, further removing directors from the process.

A Workable, Effective Solution

There is a practical solution for fixing the signature/ownership problem: Just as audit committee members currently sign off on the annual financials in a signed audit committee report (under current Item 306 of Reg S-K, which is proposed to become part of new Item 407), the compensation section of the proxy statement should be followed by a representation signed by each of the directors on the compensation committee. [Note the importance of the representation following the entire section, not just the CD&A, because there will now be significant information and narrative explanation throughout the compensation section. This would further bolster the thrust of the SEC's new rules which seem to envision that the disclosure is a single, integrated presentation.]

To reach a middle ground, this Item 407 representation need not be a "filed" document. Instead (like the audit committee report), it could be considered "furnished." And, even though it would not increase directors' exposure to liability, the process of actually "signing" the report would cause directors to scrutinize more closely the disclosures—particularly the description in the CD&A of the compensation committee's actions with respect to the CEO's compensation. [Note that even though the names could be printed in the proxy statement, our proposal would actually require companies to retain individually signed copies of the report: again to ensure that each director on the compensation committee closely reviewed the entire compensation disclosure section and 'signed off.' An ancillary benefit here would be a more critical focus

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by directors throughout the year. Awareness of what they will have to say—and sign off on—in the report at the end of the year should positively impact the actions of directors all year, not just when the report is drafted. Particularly since the CD&A makes directors explain "why" they reached their decisions, it will not be possible (or practical) to wait until year end to try to explain/justify their compensation decisions.] This signature process could also allow for director dissents.

Need for Specificity—Critical Disclosures

The second essential fix to the CD&A is that it needs much more specificity. We note that the SEC expressly requests comments on "any other specific items we should list in the rule as material information." And, the proposing release asks whether there are items that "we should specifically mandate be disclosed by every issuer." Our answer to both questions is a very strong "Yes."

What it is missing from the proposed CD&A is the second prong of disclosure. The first prong is laying out all the numbers. The second prong is telling the shareholders what was the compensation committee's assessment of and reaction to the numbers—and what actions the committee actually took when it considered the numbers. That is where the proposed CD&A is weak. To focus directors' attention on the need to provide these crucial disclosures—and to make it easy for shareholders to find them without having to pore through a lot of text—there should be a number of mandated, fundamental headings in every CD&A:

- **Tally Sheet Review and Action**

  Under this caption, the instruction should call for "a statement of whether the committee reviewed tally sheets" and "a candid explanation of the compensation committee's assessment of and reaction to the numbers—including what the committee did after considering the numbers." To be meaningful, this section must conclude with an express statement addressing whether the compensation committee found the total compensation to be "fair, reasonable and not excessive, and consistent with the company's internal pay equity policy." Those companies that disclose they do not use tally sheets would need to further elaborate on how they are able to determine that pay was fair, reasonable and not excessive in the absence of a total compensation review through a tally sheet.

  Importance:

  Shareholders are entitled to know—and boards should be expressly required to state in the CD&A—what the directors did (or did not do) when they saw all the numbers presented in the tally sheets. Tally sheets are a basic tool for all compensation committees and provide essential numbers so that directors can total up and assess all the CEO's compensation. That is why the proposals call for a new "total" column in the Summary Compensation Table. [Tally sheets may differ in format from company to company from the totals required in the SCT. But their purpose is clear: to provide directors with the total picture of the CEO's compensation. And, directors must explain what they did when presented with those numbers.]

  As a number of compensation consultants shared at the recent 2nd Annual Executive Compensation Conference, seeing the totals often results in a "Holy Cow, did we really authorize that..." moment, but then the directors go on to other items of business on the agenda, rarely taking any action to address those huge unintended numbers (thereby negating the purpose of the tally sheet process). An express statement addressing whether the compensation committee found the total numbers to be "fair, reasonable and not excessive, and consistent with the company's internal pay equity policy" should be a basic, required item in every CD&A.

  In the words of one highly respected compensation consultant: "The compensation committee should be required to make a representation on the fairness of the compensation paid the CEO. It seems to me the best way to address the concern about getting directors to take action when things seem out of line is to require that they affirm that the compensation is reasonable and appropriate (and why they believe it)."

- **Internal Pay Equity Review and Action**

  Under this caption, the instruction would call for disclosing whether the compensation committee considers the internal pay equity ratios within the company between the CEO and other executives (see as an example DuPont's proxy statement disclosure). The instruction would call for disclosure of the multiples between the CEO and the other executives, an explanation of the rationale for the multiples and how that squares with the board's and company's compensation philosophy. The instruction would call for addressing whether the company has an internal pay equity policy and, if so, whether there was a review of the findings from an internal pay equity audit. As with tally sheets, the disclosure should

require a discussion of actions the compensation committee took if it revealed unintended or inappropriate gaps (or explaining why no actions were taken).

Importance:

Disclosure of whether a board considers internal pay equity is a key disclosure for shareholders (and compensation committees) as it provides a clearer understanding of a company's actual pay practices and philosophy than all the words and puffery. It also is a major indicator to shareholders of the company's "tone at the top" and can be a warning sign of corrosive internal executive and employee morale. Shareholders are entitled to know whether the directors on the compensation committee utilized this basic tool in setting and reviewing the CEO's compensation—and what actions the compensation committee took.

- **Wealth Accumulation Review and Action**

  Under this caption, the instruction would call for a discussion of how the compensation committee factored in the accumulated wealth numbers (both realized and unrealized, and the gains projected from grants of stock options and restricted stock and other incentive compensation). [Note that former Citigroup CEO and NYSE Chairman John Reed called it a "cop out" when some boards do not look back at—and factor in—the actual gains resulting from prior grants.]

  Importance:

  Shareholders are entitled to know what the compensation committee did and whether it took this key factor into account when making its decisions about (a) stock option and restricted stock grants and (b) retirement and severance and change-in-control payments.

  There should be an instruction calling for sub-captions under the Wealth Accumulation Review and Action heading:

  – **Impact of Wealth Accumulation on Future Need for Stock Option and Restricted Stock Grants.**

    The instruction here would call for addressing specifically whether the total options and restricted stock already granted (sometimes referred to as "carried interest") has reached a level where additional grants are not called for: for example, because the carried interest is already at a level where incremental additions would not increase motivation, but might instead be incentive to "cash out" and leave the company).

    In addition, there should be disclosure addressing whether the company has implemented hold-until-retirement requirements on equity granted to its NEOs. This is important information for shareholders to know—whether top executives who may have millions of dollars worth of equity from long-term incentive grants, have a commitment to keep their "skin in the game" for the long term. (This is a different type of disclosure from 'ownership guidelines' in that it addresses the long-term nature of incentive grants, which were provided by the company to tie the executives' interests to the *long-term* interests of shareholders.)

  – **Impact of Wealth Accumulation on Retirement, Severance and Other Post-Employment Payments.**

    An instruction should require that the company address whether, in view of the amounts accumulated at that point, there is any "need" for additional payments. The instruction should also require disclosure of whether the compensation committee has set a target for accumulated wealth at retirement and whether retirement, severance and other post-employment payments would kick in only to make up any shortfall.

  Importance:

  The two components of CEO compensation where the most questions have been raised about excesses are (a) stock option and other equity grants, and (b) post employment payouts. [For example, today's median annual stock option grant at companies with $3-$6 billion in revenues has now risen to more than twice what was considered a huge, often indefensible, one-time mega grant in 1988. (It can be eye-opening when directors see the chart posted on CompensationStandards.com.)] And, it is these components of CEO compensation that an internal pay equity audit will most often reveal to be out of line when compared with the company's historic internal pay equity ratios between the CEO and other executives and employees within the company. Shareholders and responsible critics have expressed frustration that many compensation committees have not factored wealth accumulation into their decision making when continuing to make annual grants or when reviewing post-employment provisions. The above sub-captioned sections should be a basic, required part of every company's CD&A.

  [To the SEC's credit, the proposing release provides an example of the type of disclosure that should be addressed in the CD&A: "How compensation or amounts realizable from prior compensation (*e.g.*, gains

from prior option or stock awards) are considered in setting other elements of compensation (*e.g.*, how gains from prior option or stock awards are considered in setting retirement benefits)." Unfortunately, without mandating a captioned section with the specificity we are suggesting here, it will be easy for companies to fudge their treatment of this item. Instead of leaving companies free to provide the inadequate disclosure that will only cause shareholders and critics to wring their hands after the fact, a specific mandated requirement (bolstered by the principles-based admonition underlying all these disclosures) will produce the intended disclosures from the start, avoiding the need for the Commission and Staff to have to issue subsequent clarifying releases and interpretations down the road, as was necessitated with the SEC's MD&A experience.]

Additional Important Captioned Disclosures

- **Benchmarks**

  There should be an instruction requiring that whenever a compensation committee has referred to surveys or data (*e.g.,* gleaned from proxy statements) on elements of other CEOs' compensation in its deliberations, the committee also must state whether it considered and addressed other important benchmarks and factors, particularly (a) the company's internal pay equity ratios and (b) the wealth already accumulated. [The SEC only goes half way here by providing an example that there be discussion of "Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies)." What also needs to be addressed is whether, after looking at the external data or survey numbers, the compensation committee looked internally at its own company's internal pay equity and the impact within the company of chasing external numbers that may not take into account all the various components of the company's own compensation package, including the wealth already accumulated from previous compensation and grants.]

  Importance:

  Compensation consultants, from Fred Cook of Frederic W. Cook & Co. on down, are saying that surveys and data cannot be looked to in isolation. The numbers are flawed and are based on years of baked-in inflation and should not be relied upon automatically. Each company's circumstances are unique. Shareholders need to know whether the compensation committee looked at internal benchmarks and factors within the company—and what weight they were given in relation to external surveys.

- **Open-Ended Payments**

  There should be a caption calling attention to any open ended payments—such as SERPs and severance and change-in-control arrangements—that are based on formulas or numbers that can change. (Surprisingly, some commentators have suggested that because these numbers are so difficult to project, *no* disclosure should be provided.) The instruction should require that the compensation committee address whether these potentially large, material payment provisions contain any limits that would prevent unforeseen amounts to be paid (and unintended obligations on the company) and, if so, what the number is, and if not, an explanation by the compensation committee as to why they left it entirely open ended.

  Importance:

  This addresses squarely a major flaw singled out by lawyers, consultants and critics in many SERPs, severance and change-in-control arrangements and lets shareholders know whether the compensation committee actually focused on it and attempted to protect the company's interests.

  [It should be noted here that a side benefit of having CFOs on the hook (through SOX certifications) is that CFOs will now have a direct responsibility not only for (a) making sure that all the numbers are accurate and have been placed on the table, but also for (b) addressing what, up until now have been sleeping internal controls issues in the compensation arena—which we raised in the September-October 2004 issue of *The Corporate Counsel* at pg 9). Now, those with sharp pencils will be obliged to address (and cap) open-ended liabilities such as the above payout obligations, including tax gross-up provisions. This could also have the salutary effect of causing auditors to focus on needed controls in these areas.]

- **Deviations From Previously Disclosed or Projected Payments or Practices**

  This captioned disclosure is important for shareholders and addresses a potential gap in the SEC's proposal. For example, if the company pays more to a departing CEO than was disclosed or projected in prior proxy statements, directors should be required to disclose and explain (in a captioned section) how (or why)

it happened. Requiring this disclosure would allow shareholders to better assess whether their directors acted in the shareholders' best interest.

There should also be a required instruction to disclose the extent to which CEO compensation exceeded the projections on which prior compensation decisions were based. The disclosure should address why the deviation occurred and how it was factored into and affected any current compensation decisions. For example, if gains from options or restricted stock exceeded amounts projected at the time of the award (or if a bonus is triggered by an unanticipated windfall event—*e.g.,* ExxonMobil's recent oil price-caused bonuses), directors should have to disclose that fact and explain how the unanticipated benefit affected the committee's determination of current compensation.

- **Payments in Excess of the 162(m) One Million Dollar Cap (And Other Non-Deductible Compensation)**

  It appears that the current requirement to discuss the compensation committee's policy about complying with the IRC Section 162(m) one million dollar cap may have been inadvertently dropped from the proposed CD&A. The feedback we have received from several members of our CompensationStandards.com Task Force was that they expected this item of disclosure to be expanded, not dropped. The instruction for this captioned section should call for disclosure of the amounts paid to each of the NEOs that were not deductible and an explanation as to why. This tax discussion should also address other expenses the company has incurred that are not deductible, *e.g.,* by providing corporate aircraft and other perks for personal use. (Note that loss of the company's tax deduction is the equivalent of the company paying a tax gross-up; it is an additional real compensation cost.)

- **A Performance Graph—No Need to Throw the Baby Out With the Bath Water**

  We can't forget the importance of squaring a CEO's compensation against the performance of the company. As a number of respected compensation consultants have pointed out to us, having a graph to focus the attention of the compensation committee is a useful discipline. And, it enables shareholders to compare performance. A problem with the current graph is that many companies use different peers (or different metrics) from those in the stock performance graph when assessing the CEO's compensation. A graph of peers actually used by the compensation committee to test performance against—and the performance metric actually used to measure performance—would permit apples-to-apples comparisons. And, now with principles-based disclosure as an underpinning, companies that might be tempted to "game" the graph by "cherry picking" presumably would have to lay it all out in the accompanying explanation.

[Note, that all the above "mandated disclosures" address fundamental practices that compensation committees should be addressing in their disclosures. They are by no means exclusive, which is why our suggested approach combines both principles-based disclosure and critical, mandated disclosures.]

A Happy Marriage: Providing a Clear Framework With Principles-Based Underpinnings

Our concern with the CD&A as currently proposed is that it lacks both a specific framework that shareholders will find user friendly and navigable, as well as critical specificity about certain items that all companies should be addressing in their disclosure. As a result, even well intentioned drafters will end up with CD&As that are all over the lot. We note that one highly respected practitioner, in a recent webcast about the proposals, urged that even the most responsible drafters will need much more specific guidance than is currently proposed. [We are reminded of the skeptical comments from Commissioner Campos during the January 17 Open Commission Meeting, in which he referred to the evolution over years of the MD&A disclosures. What we are suggesting would address his and others' valid concerns.]

The most searing criticism of the current compensation committee report (which will also apply to the proposed CD&A if adopted as proposed) is that most shareholders or even compensation consultants don't bother to read it or take it seriously. We believe that providing the structure and the specifics set forth above will remedy that. And, because there will also be plenty of opportunity for free form disclosure (covering, *e.g.*, "what we did," "why we did it" and "what else happened") and because there would be specific instructions preceding the mandated disclosures reminding drafters that even those disclosures are principles-based and must provide all relevant information so as not to be misleading, the final product should result in the best of both approaches.

We don't see the CD&A as an "either/or" proposition. We believe very strongly that it can accommodate both a principles-based approach and a more detailed framework, thereby combining the best of both approaches and providing shareholders a consistent framework that will result in meaningful, truly helpful information. What we envision would provide consistency so that shareholders will be able to more easily

access the critical aspects of the report, while at the same time, employing the principles-based approach to get beyond boilerplate and down to the heart of the kinds of disclosures that should be provided to shareholders. Instead of being limiting, the framework would ensure that all the bases are, in fact, covered in a meaningful way. The result will be a report that actually would provide the key disclosures that shareholders should expect to see in every CD&A.

Filed vs. Furnished

We are aware that some of our colleagues may fear that making the CD&A a "filed" document will chill disclosure. Back in 1992 when it adopted the current rules, the SEC took into account similar comments that the CCR should be "furnished" rather than filed to allow for a more robust discussion in the reports. We agree with the SEC that the compensation committee reports did not benefit from the furnished status and did not result in the more forthcoming discussion that some commentators suggested would result.

It has also been suggested that a CEO (whose SOX certification would also cover the contents of the CD&A) may not be privy to the executive sessions of the compensation committee and therefore, not be able to certify as to accuracy/completeness of the CD&A. Our response to this is that CEOs nevertheless should be fully aware of every aspect of their own compensation. And, more importantly (as articulated at the 2nd Annual Executive Compensation Conference by respected directors and former CEOs—and in JPMorgan Chase CEO Jamie Dimon's forthright luncheon speech), at the heart of a functional relationship between a compensation committee and the CEO, is candid, open discussions about the reasons and objectives and the basis for each element of the CEO's compensation—and how it all fits into the board's and company's strategic objectives. In short, the very disclosures that the new CD&A is aimed at addressing. It is fundamental that a CEO should know all the numbers and all the reasoning that went into his/her compensation.

We do believe that making the report "filed" will bolster the integrity of the disclosures and—with the specific mandated disclosures recommended above—will result in more complete, useful disclosure for shareholders.

A Report of the Compensation Committee? Or the Company?

As we said at the outset about the need for signatures—and as should be clear from the list of critical specific disclosures above—regardless of whether it is called a "Compensation Committee Report" or a "CD&A," the compensation committee must take ownership of all this disclosure and treat it as the report of the compensation committee. The adopting release will need to make this clear to avoid the risk that some may turn this into a report prepared by the company and management—and only shown to the board at the end of the process. (It would be a shame, especially with the new disclosure required by proposed Item 407 aimed at taking management's control out of the process of setting the CEO's compensation, to have this report drafted by the recipient, and his/her reports, rather than the setter of the compensation.) The adopting release will also need to reiterate the SEC's admonishment to those of us who draft and review the disclosure that our ultimate client is the shareholders.

More Hand-Wringing and Ratcheting?

We are keenly aware that many skeptics believe that the SEC's proposed proxy disclosure rules will not address the excesses and, in fact, will result in more hand-wringing now that *all* the numbers are out there—and even more ratcheting of CEO pay as more CEOs see huge totals paid to others and say "me too." We are also very much concerned about the need to restore trust in our system and in each of us who has a role in the compensation setting and disclosure process. And, we are mindful of the corrosive influence of excessive pay on executives and employees at some companies, as they see their CEO's compensation getting further removed from the core values of their company.

It is these very real concerns that have caused this writer to feel so strongly that each of us must do our part to rectify things.

The SEC. A number of the Commissioners said (during the January 17th Open Commission Meeting) that all they can do is require disclosures—that it will be up to the shareholders to do the rest. But before passing the ball to shareholders and critics, we need to make sure that the critical fixes to the required CD&A disclosures are made so that shareholders will, in fact, have all the information they need. The proposed CD&A is lacking, putting too much faith in broad principles-based disclosure, without enough specific required items of disclosure.

Those of Us Submitting Comments. We have been particularly impressed with how much the Staff wants to get things right—and how open the Staff is to comments that will improve the proposed rules. It is important that we each do our part to restore trust in our system and face up to disclosures that will address

and help eliminate the excesses that have gotten baked into CEO compensation practices. Just presenting numbers will not be enough. It must be accompanied by open disclosures of actions that compensation committees took when presented with excesses—hence, the importance of each of us getting behind internal pay equity disclosures and the other specific disclosures set forth above. We must recognize that it is in all of our long term interests to support these important disclosures.

More to Come

Because the CD&A will be so critical, we have kept the focus of our comments in this issue to the CD&A. Among the other big picture disclosure fixes we will be addressing shortly (and posting on CompensationStandards.com) are:

The Need for Two Summary Compensation Tables. One table would cover the compensation granted or targeted by the compensation committee during the year. The second table would cover the compensation actually realized (vs. what was projected). Note that the SEC requests comments regarding a two-table SCT approach (at pg 59 of the proposing release). This will enable shareholders to see the compensation picture in the same manner that the directors on the compensation committee should be looking at compensation: both (a) at the time the compensation is set and then (b) assessing after-the-fact what was actually realized (vs. what was projected) and how that should impact future compensation. (Our CompensationStandards Task Force members are currently preparing a model of how this two table approach would look.)

Airplane Perks. The new perk disclosure guidance from the SEC needs a critical fix so that shareholders can assess the value and usage of airplane perks. As covered in our September-October 2005 issue, the disclosure should focus on the *value to the executive* because it is compensation to the executive. "Incremental cost" is not the appropriate measurement approach as it does not address the value to the executive. (It is like saying stock options should not be treated as compensation to the executive because there is no incremental cost to the company if the company does not pay out any cash and is not taxed on the executive's gains.) Moreover, companies calculate their incremental cost in different ways, so that there is a lack of consistency allowing shareholders to compare and assess. Also, incremental cost does not pick up "deadhead" costs or the value realized when the CEO's spouse "hitch hikes" on the CEO's business trip.

The fix here is to provide a consistent "retail cost to the executive" approach—the cost to the individual of chartering a comparable private jet. If the company discloses the total retail value to the executive and provides the hourly rate (which one proxy statement pegged at $7,000 dollars an hour "based on a competitive analysis of comparable leased aircraft") *and* if the disclosure also set forth the hours used by the CEO and his/her invitees, shareholders will have a more accurate, consistent picture of what compensation is being provided.

Just lowering perk reporting thresholds will not address this fundamental problem involving what is often the largest perk a CEO receives. Under the new guidance, it still is not possible to assess the true number a company is attributing to the use of its private jet—and whether it is a low ball number. There has to be open, consistent disclosure so that shareholders (and compensation committees) can add the "real-value to the executive" to his/her total compensation.

Providing a Single Wealth Accumulation Amount. As covered above, a wealth accumulation table is a critical tool for compensation committees (and, hence shareholders) to utilize when assessing the need for, and size of, future equity grants as well as retirement and severance and other post-employment payments and benefits. The proposed disclosures do not call for some of the information necessary for shareholders to see the total wealth accumulation numbers.

Ideally, there should be a separate table. Short of that, the proposed *Option Exercises and Stock Vested* table needs additional columns (or at least footnote disclosure) that would provide the *cumulative* total value of (a) all gains realized and number of shares acquired from options exercised to date and (b) the current market value and number of all vested restricted stock (not just what was exercised and vested during the past year). Additionally, the disclosure should provide the aggregate dollar value of previously "realized" gains from equity awards (*i.e.,* shares sold that are not already included in the table). In this way, shareholders can add that "gains realized" number to the total value of outstanding awards from the *Outstanding Equity Awards* table to arrive at a total wealth accumulation amount. Better yet, the disclosure should provide that total.

The New Corporate Governance Section (Item 407). We like the concept of pulling all the corporate governance disclosures together. [To avoid redundancy, however, we would perhaps require that the compensation committee disclosures addressing the committee's process of evaluating and setting CEO

compensation be set forth in the CD&A/compensation committee report so that it is all in one place. And, as stated above, we would provide at the end of the compensation section the signed report/representation, comparable to the audit committee representation, proposed now in Item 407(d)(3).]

A Final Word

As we said at the outset, we very much like the thrust of the SEC's proposals. Now it is up to each of us to help make the final rules achieve their potential. Failing to require disclosures that actually go to whether the committee has made the difficult decisions and taken the actions that are necessary to actually address and rein in the excesses will not change things.

It will be for each of us to keep everyone's focus on the big picture. With all our help, these proposals can be enhanced to make a big difference. We will be posting our additional comments, as we complete them, on CompensationStandards.com. We welcome our readers' input.

NEW DEVELOPMENTS

Although we did not want to detract from the above with our regular "New Developments" section, the following "Heads Up" seemed appropriate and timely. (We will be accelerating the timing of our next regular issue of *The Corporate Counsel,* which we anticipate will mailed by the end of March.)

A Heads Up

As we said above (at pg 2), compensation actions taken during this year will be subjected to more detailed CD&A disclosure and more forthcoming analysis and explanation of the compensation committee's practices and actions with respect to each element of the CEO's compensation and the totality of the current, as well as projected, compensation. Companies that wait until after the new proxy disclosure rules are adopted to address current practices could find themselves in an awkward position of having to disclose the absence of basic tools that the disclosures implicitly assume are being utilized by compensation committees. For example, as currently proposed, among the 13 examples of issues to be addressed in the CD&A, is whether (and how) wealth accumulation and gains from prior stock option grants were factored into current decisions. [In addition, compensation committees will not want to wait until the last minute to revisit their charters which will now have to be provided under new Item 407. To assist our readers in gearing up for meeting the new requirements, we will be posting on the CompensationStandards website ongoing guidance—including new compensation committee charter provisions and checklists that companies may want to consider adopting.]

In short, it behooves us all to focus on implementing—well in advance of the rule changes—the basic practices and tools that shareholders will expect to see in the CD&As covering 2006. To make sure that your directors are up to speed now, we hope that our readers are utilizing—and furnishing to all directors—now in particular, the 12 Step Guidance for Directors set forth in our September-October 2005 issue as well as the executive summary of the latest guidance for directors from the 2nd Annual Executive Compensation Conference. And, we encourage everyone to take advantage of the implementing guidance on CompensationStandards.com for companies that are (or will be) implementing the four basic tools for compensation committees.

—JMB

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We are granting permission to forward this issue on to others—particularly directors—because so many boards need to implement changes [and because the necessary changes go beyond cosmetic "process" fixes—which directors will need to understand and incorporate *now*].

To do our part to facilitate access and allow for e-mail distribution, we have posted an electronic version of this issue—including the Conference Summary and the updated 12-Step Guidance for Directors—on CompensationStandards.com.