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Compensation Discussion and Analysis Scorecard

Watson Wyatt Worldwide

Watson Wyatt Compensation Discussion and Analysis Scorecard

The Securities and Exchange Commission's (SEC) proxy disclosure rules, effective for 2007 proxy filings, require extremely detailed and complicated disclosures to be prepared by companies. These rules also require the company to draft a Compensation Discussion and Analysis (CDA). The CDA should follow guiding principles issued by the SEC, which require disclosures of information that is material to shareholders' understanding of the company's compensation programs.

Because compensation committees are required to attest to the CDA drafted by management, Watson Wyatt has created a Compensation Discussion and Analysis Scorecard that permits directors to review draft CDAs and evaluate whether the information included would be of value to shareholders. Due to the nature of the SEC rules, this scorecard will require subjective determinations to be made by directors in rating the elements of the CDA. Nonetheless, we believe the directors that use this tool will be better able to discuss with management the issues that may need more vibrant disclosure.

Ratings

1 = Material elements appear to be missing
2 = Adequate details with less than adequate explanations
3 = Slightly better than adequate; attempt made at explanations, but logic may be lacking or descriptions are confusing
4 = Very good disclosure of most material elements; extensive details, although there may be gaps in reasoning or less clarity then might be ideal
5 = Best in class discussion; vibrant discussion of the issues with clear and concise plain English with tables to add clarity

Relevant CD&A Element	Rating	Qualitative Guidelines
1. Overall Clarity and Ease of Use • An executive summary-style introduction that prefaces the body of the CDA and provides an overview of how the company performed and how compensation paid was commensurate with that performance • Tables to help clarify complex ideas • Plain English descriptions • A complete narrative that requires minimum cross-referencing (with the exception of cross-referencing to tables) • No boilerplate discussions from prior year compensation committee reports		The best CDAs include: o An executive summary that encapsulates much of what will follow and sets the stage for upcoming disclosures o Tabular disclosures that save time and add clarity instead of long paragraphs that contain excessive data for multiple named executive officers (NEOs)

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2. Objectives and Disclosure of Performance Goals • Objectives of the company's compensation programs • Individual or corporate behavior the program is designed to reward • Actual performance goals for the annual and long-term incentive (LTI) plan and a detailed description of the metrics used o If targets are not disclosed due to confidentiality, a discussion of the likelihood the targets will be met and the method by which that estimate was determined • Factors considered in increasing or decreasing compensation materially		The best CDAs include: • The actual performance goals where such have been pre-established (unless the goals are confidential and the difficulty of attaining goals is disclosed) • How programs are focused on registrant's unique business goals • A vibrant and expansive discussion that describes how the program was designed to pay for performance and sets the stage for later discussions of how programs actually rewarded performance • Discussion of factors considered in increasing or decreasing pay or in appropriate discussion of individual compensation elements
3. Benchmarking • Extent to which total compensation is benchmarked to peers and/or survey data (should include the definition of total compensation for these purposes and the reasons for omitting certain elements) • Extent to which Individual compensation components are benchmarked to peers and/or survey data • Peers and surveys used • Reasons for selecting the peers/surveys o If peer/surveys vary for different compensation elements, reasons why • Extent of management's and compensation committee's involvement in the selection process		The best CDAs include: • Affirmative statements regarding management's, the consultant's and the compensation committee's involvement in the peer group selection process – in essence, a description of how the process works • A listing of the peer companies and the names of the surveys used
4. Discussion of Pay Mix • Policies for allocating between long-term and currently paid out compensation • Policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation • Targeted percentiles for total compensation and each compensation element		The best CDAs include: • A discussion of how the pay mix helps facilitate the compensation objectives and goals even if the company does not have a formal policy for these allocations • Tabular representation of pay mix that can easily be understood • The targeted percentiles for the company versus its peers

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5. Actual Results and "Pay for Performance" • How at-risk compensation programs actually rewarded executives for missing, attaining or exceeding the plans' performance targets • How the metrics for at-risk compensation programs helped to drive the performance being sought by shareholders • Comparison to peers of at-risk compensation paid where peers generated similar corporate performance		The best CDAs include: • This discussion separately as an Executive Summary prefacing the CDA, following the discussion of the pay program objectives or in the individual discussion of the pay components • An analysis of how the pay provided for the proxy year actually tied to the targets and performance metrics and how those compared to peers • Minimal discussion of how the company compared to peers on metrics not measured nor rewarded under the pay programs
6. Salary • The process for determining salary for each NEO • Factors considered in this determination • NEO involvement in the process, including selection of peer group and/or use of survey data • Relationship between salary and other elements of compensation		The best CDAs include: • A comprehensive yet economical discussion of the salary-setting process especially where multiples of salary are used to measure the annual incentive compensation opportunity • How the peers are selected and who is involved in the process, where salary-setting is driven largely by peer comparisons or survey data
7. Annual Incentive Compensation • How compensation elements are structured and implemented to achieve company-wide and individual performance goals • How the company did in relation to those goals • Whether discretion can be exercised to award compensation absent goal attainment or to reduce or increase the size of any award or payout; whether plan is designed to meet 162(m) • Whether discretion was applied to one or more specified NEOs for the fiscal year and the rationale for doing so • Extent to which, and reasons why, deferrals are permitted for payment in later years; how earnings are credited and matching contributions are provided with rationale • Changes made to the program from prior years and the reasons for those changes • NEO involvement in the process, including selection of peer group and/or use of survey data		The best CDAs include: • A comprehensive yet economical discussion due to its relative importance and variety of plan design permutations prevalent • Tabular descriptions of actual targets and metrics with a column showing goals attained and actual payout • A vibrant discussion of how likely it is the goals will be attained and how this likelihood was determined (if targets are not disclosed for confidentiality concerns) • Reasons why discretion has been exercised to adjust pay, even though such disclosure is not required by 162(m) • How annual incentive compensation payments corresponded to corporate performance to reinforce how the program is designed to pay, and actually pays, for performance

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8. Long-Term Incentive Compensation
• Description of the basis for allocating long-term compensation to each type of equity and cash award
  o Relationship of the award to corporate and NEO goals, including a detailed description of each NEO's targets and metrics
  o Reason for selection of equity vehicle and performance/time-based vesting, and management's exposure to downside equity performance risk
  o Correlation between cost to registrant and expected benefits to registrant, if considered
• How the company did in relation to those goals
• Whether discretion was applied to one or more specified NEOs for LTIP payouts for the fiscal year and the rationale for having exercised that discretion; whether the plan is designed to meet 162(m)
• Extent to which, and reasons why, deferrals are permitted for payment in later years; how earnings are credited and matching contributions provided with rationale
• Changes made to the program from prior years and the reasons for those changes
• For equity-based compensation, how determination is made for the award grant date
• NEO involvement in the process, including selection of peer group and/or use of survey data
		The best CDAs include:
		• Tabular descriptions of targets and metrics with a column showing actual payout
		• A vibrant discussion of how the company determined the likelihood goals will be attained (if targets are not disclosed)
		• How the grant of LTIP opportunities correspond to prior year performance, existing outstanding equity opportunities, forecast SERP and pension plan accruals and other potential LTIP pay elements
		• A discussion about how the LTIP program is designed to and has actually accomplished the goal of pay for performance through empirical analysis of payments made compared to both its own corporate performance and that of its peers

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9. Change-in-Control (CIC)/Severance Provisions • The basis for selecting particular events as triggering payment at, following or in connection with termination or CIC (e.g., the rationale for providing a single trigger for payment in the event of CIC) • Extent to which plan designs were benchmarked to peers or industry practices • Whether the compensation committee considered the magnitude of payments at each potential triggering event in making its compensation-setting decisions • Decisions/changes made regarding changes to the magnitude of these payments and the reasons for doing so		The best CDAs include: • Rationale for the payments that will be disclosed in the Termination Scenario section of the tabular disclosures • Details on the activities the compensation committee undertook to understand the magnitude of these payments and a discussion of their reasoning for making changes in the programs or maintaining them at current levels • The total walk-away value, rather than the incremental value received due to the triggering event, as this provides a strong indication the compensation committee understood the results of their action
10. Accounting and Tax Considerations • The impact of accounting and tax treatments of a form of compensation		The best CDAs include: • An interwoven discussion of these issues: o 162(m) and its implications in the appropriate annual or long-term incentive compensation section rather than including the same boilerplate from prior year proxies in a stand-alone section o FAS 123R and its impact in the Pay Mix or the LTIP discussion, if it influenced the decision to convert from stock options to another vehicle
11. Role of Consultants • The role of compensation consultants in determining or recommending the amount and form of executive and director compensation • The names of the consultants, stating: o If they are engaged directly by the compensation committee o The nature and scope of their assignment o The material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement		The best CDAs include: • A discussion that is interwoven into the selection of the peer groups, how the performance goals and metrics are developed, and what percentiles versus peers are being targeted by the compensation program

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The following are additional provisions that should be discussed only if relevant for the company. Since not all companies would include a discussion of these elements, no rating should be provided.		
12. Clawbacks • Policies or decisions regarding adjustment or recovery of awards or payments if the relevant registrant's performance measures are restated or otherwise adjusted in a manner that would reduce the size of the award or payment		• Clawbacks are not required by law, although many companies are considering adopting such policies if they have not done so already.
13. Stock Ownership Requirements • Policies that require NEOs to attain a certain level of stock ownership after a period of employment		• Stock ownership requirements are not required, although they are becoming a prevalent practice.
14. Accumulated Wealth • How compensation or amounts realizable from previous compensation affect other elements of compensation o How gains from prior option or stock awards are considered in setting retirement benefits o How previously realized equity affects current year decisions on new grant levels		• The SEC appears to be suggesting that companies should consider all elements of previously earned compensation in an "apples to apples" comparison when making current year grants. To date, this is not yet a prevalent practice in setting current year compensation levels.

locations

ASIA-PACIFIC ▪ Bangalore ▪ Bangkok ▪ Beijing
Calcutta ▪ Delhi ▪ Hong Kong ▪ Jakarta ▪ Kuala Lumpur
Manila ▪ Melbourne ▪ Mumbai ▪ Seoul ▪ Shanghai
Shenzhen ▪ Singapore ▪ Sydney ▪ Taipei ▪ Tokyo ▪ Wuhan
EUROPE ▪ Amsterdam ▪ Birmingham ▪ Bristol
Brussels ▪ Budapest ▪ Dublin ▪ Düsseldorf ▪ Edinburgh
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