

Changes To Pay Disclosure Rules May Be Imminent

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Thursday, Jun 07, 2007 --- As the proxy season came this year, many investors were left scratching their heads trying to discern what companies really paid their executives despite rule changes meant to tell them just that.

In an attempt to make executive compensation more transparent for shareholders, the U.S. Securities and Exchange Commission changed the executive disclosure rules last summer.

The changes were twofold. Companies now have to include more tables with much more detailed information about pay. They also have to complete a compensation discussion and analysis or CD&A, explaining the thinking behind an executive's pay.

The process for companies, lawyers say, was arduous, and may have fallen short of the intended effect.

The CD&A, for example, "added a lot of length to proxy statements, but not a lot of useful information," said Howard E. Berkenblit, a partner and co-leader of Sullivan & Worcester's securities and corporate finance practice group. "The intent was good, but what we ended up with are lengthy diatribes that people aren't reading and are finding hard to follow."

The public has been critical as to whether the statements are written in plain English. Consider this sentence from American Vanguard's Compensation Discussion and Analysis: "Through this hermeneutic, the committee selects grant dates and recommends awards that are perceived to be of value, that are consistent with those made by our peers, that have a reasonable financial impact on the company, and that are warranted by the company's and executives' performance."

Some attorneys, however, said that just going through the process of completing the CD&A was positive.

"One of the interesting things that happened was that it made people look at their compensation practices. They sat back and looked at what they were paying, and asked 'Is this really what we are paying? Is this what we should be doing?'," said Shannon Skinner Anglin, a partner with Katten Muchin Rosenman LLP.

Prior to the changes, companies were also required to produce a series of tables. The SEC was concerned, however, that companies weren't giving the

complete picture since nitty gritty of perks, severance packages and the value of options wasn't included.

So the number of tables has increased, and now all of those details must be disclosed. “Few companies just have salary and bonuses. Most have complicated incentive plans or retirement arrangements. It's very technical, and involves many different people within an organization, so corralling them and working through this was challenging,” Berkenblit said.

Companies and lawyers, though, will likely see the SEC tweak the rules for next year. Attorneys said that a provision allowing employers to not disclose performance targets they set for their executives by citing a confidential treatment exclusion is particularly vulnerable to change or at least scrutiny.

In a speech last month, John W. White, the director of the SEC's division of corporate finance, hinted they were correct to think so.

“Investors have made it very clear that they want this information and that it is quite material to them. I am not interested in suggesting any loosening of the confidential treatment standard,” White said. “We have great respect for those standards in the Division of Corporation Finance. At the same time, though, public companies need to employ the same respect for the rules as we do, and not try to claim cover from them if the company's facts do not in fact fit within the rules. And as part of our review process in Corporation Finance, the staff will be prepared, as appropriate, to ask companies to justify their use of the exclusion. Companies that are using the exclusion and therefore not disclosing their specific performance targets should be prepared to provide the staff with an open and full explanation of those decisions and those targets.”

White said his division was reviewing the disclosures filed by a critical mass of companies and intends to publish a report this fall. But throughout the speech, he said how he believes the process has forced out much information that investors previously weren't getting.

“We are just now beginning to see the vast wealth of new information that these rules are providing investors,” White said. “Both the fans and the detractors that I just mentioned are absorbing and analyzing the new data, and we are still early in that process. I think we can all agree, however, that the new rules have made a difference and are having a real impact for our markets and the investing public. And they are producing disclosure that is grabbing headlines almost every day.”

While lawyers involved with the process also see downsides with some aspects of the changes, many also pointed out that the changes were positive overall.

Alan M. Levin, a partner in Morrison Cohen LLP's executive compensation and benefits/ERISA group, said that the process of preparing the statements was more robust, and that having increased involvement from different

disciplines within a company is positive.

Berkenblit compared the rule changes to the Sarbanes-Oxley Act. “The intention is good, and some good is coming out of it. Before, for example, investors and the company didn't always have the full picture of severance. Now they know what the CEO would get if he or she were fired. Would he or she get the money in a lump sum? How would it be paid out? They won't get in a Home Depot situation.”

Anglin, too, said that overall the rules are a good thing, particularly because the changes made compensations committees sit back and look at their pay packages.

“Perhaps the SEC can come up with a way that's a little easier to understand,” she said. “But executive compensation is really a complex area. I don't think that everyone necessarily appreciates how complicated it is. No two arrangements are the same. There are similarities, but the differences are hard to articulate in a chart.”