

Will Your Proxy Keep You Warm at Night?

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It's often said that we as Americans are more comfortable talking candidly about our sex lives than about how much money we make (unless of course you're a professional sports figure when both topics are fair conversation). Rarely is that more apparent than during the corporate world's proxy season when the annual hand-wringing begins over what precisely should be disclosed in connection with the compensation, benefits and "perks" of the senior executive officers of a reporting company – and this year, there's even more to discuss. So, if you thought the lives of the famous or infamous are interesting, just wait to see what the federal government and the Securities Exchange Commission now have in store for us.

By way of background, the federal securities laws require clear, concise and understandable disclosure about compensation paid to chief executive officers, chief financial officers and certain other high-ranking executive officers of public companies. Several types of documents that a company files with the SEC include information about the company's executive compensation policies and practices. The vast majority of this information about executive pay can be found in four documents filed with the SEC: the company's annual proxy statement; the company's annual report on Form 10-K; (3) registration statements filed by the company to register securities for sale to the public; and the company's current report on Form 8-K.

For most public companies, the document that will garner the most attention from shareholders looking for information regarding a company's executive pay practices is the company's proxy statement – specifically, the part of the proxy referred to as the "Compensation Discussion & Analysis" or "CD&A" as it more commonly called. Compensation committees, human resource departments, legal departments, and outside advisors with responsibility for their company's CD&A

will probably not rely as heavily this year on the prior year's proxy due to the changes brought about by the Dodd-Frank Act, among other things. So if you were hoping to only make a few edits and update the numbers in the executive compensation disclosure part of your company's proxy statement, you might want to set aside some extra time this year.

The proxy statement, in general, and the CD&A in particular, are meant to convey detailed information from the company to its shareholders on an annual basis. Simply put, it should detail a story, with a message, about where the company has been during the past year, and where it plans to be in the future. With that goal in mind, a good place to start in developing your company's proxy "message" is to set up a meeting with all of the parties that will be responsible for drafting this year's proxy (i.e., members of legal, human resources, outside counsel, and independent consultants) in order to decide what type of message the company wants to get across to its shareholders. This message should then be the theme that is consistently applied throughout the document.

One way to make sure that the chosen "message" is clearly conveyed in the CD&A is by including an executive summary at the beginning of the CD&A. Given the length of most CD&As, executive summaries are becoming increasingly useful, and make it easier for shareholders to understand what the company is doing and why it is doing it, as well as how the company's executive compensation system supports the company's business strategy and improves shareholder value. Doing this will allow the company to better set the tone for the CD&A, and is especially appreciated by investors, who must read and analyze a large number of documents across their portfolio companies to determine their votes.

Remember, however, that it is of paramount importance that your company's CD&A provide the shareholders with a very clear understanding of the logic for the decisions taken in compensating the executives and to ensure transparency of the executive pay programs. If the company is modifying the way in which it is compensating its executives, you should describe last year's programs, explain how and why the programs are being changed, as well as how the proposed changes fit in with the larger "message" of the proxy.

A good way to accomplish this is to devote a section of the CD&A to a discussion of the company's overall compensation philosophy and objectives, and how the company's programs to compensate the executives help to achieve these goals. Tables and charts can be added to the CD&A discussion as simple and effective takeaways for readers, making the relevant information easy to understand. Another section of the CD&A may also be devoted to the company's pay and performance alignment, describing how the company's performance and bonus plans actually translate good performance into executives' pay. Although a discussion of pay and performance will not be required until next year's proxy, it is a good idea to address pay and performance in this year's proxy as well, because it will allow the company to demonstrate its track record of aligning pay and

performance over time. Do not be afraid to point out any pay and performance disconnects. This can be an excellent opportunity to let shareholders know that you are mindful of their concerns by explaining to them not just what happened, but why, and how it fits in with management's vision for the future of the company.

Along these same lines, be candid when describing the pay actions the company undertook in the prior year for the CEO and why these actions were justified. This is yet another opportunity to provide a chart. Certain companies include charts comparing the total compensation of their CEO to earnings per share and total shareholder return over, for example, a five-year period. By doing this, they offer their shareholders a succinct view of how their total CEO pay is directly affected by the company's performance.

If nothing else, keep on asking the word "why" when drafting your CD&A: Why is this policy in place? Why was this particular decision or action taken? Why do we think we need to change these parameters? Make your CD&A a great public relations tool. Set a positive tone. Sell your message by supporting it with the full disclosure and transparency required by the applicable rules. Your investors will appreciate it...and so will the SEC.



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