DRAFT
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Discussion Points for JCEB Meeting with SEC Staff
May 2, 2006
(revised)

I. Introduction

1. We support the Commission's decision to expand and enhance the disclosure of director and executive compensation and related matters, and generally support the specific provisions contained in the recent proposals. However, certain aspects of the proposed disclosures raise technical issues or fail to accommodate or reflect actual practice.

2. We view this meeting as an opportunity to educate the Staff as to some of the issues raised by the proxy rule proposal.

3. Views expressed by an individual do not necessarily reflect the views of the entire group or of the ABA. Views of the ABA Federal Regulation of Securities Committee will be contained in our forthcoming comment letter.

II. Compensation Discussion and Analysis

1. Not clear that treating CD&A as a filed, rather than furnished, document will lead to more forthcoming disclosure and eliminate (or reduce) use of "boilerplate" language

   a. Primary criticism of Board Compensation Committee Report is generality, not accuracy

      (i) By and large, the BCCR's of most large registrants have evolved over the years and reflect many of the six elements that would be required by proposed Item 402(b)(1)

      (ii) However, many registrants provide a very general description of their executive compensation policies and decisions

   b. Expansion and enhancement of required disclosure through introduction of new CD&A format should change this

      (i) Proposed instructions reflected in proposed Item 402(b)(1) and (2) should provide enough specificity about required (and desired) content of CD&A to adequately address "boilerplate" concerns

   c. Simply enhancing the scope and specificity of the disclosure requirements as to the matters to be discussed will have a more direct impact on the quality of disclosures than changing the disclosure's status from "furnished" to "filed"

d. Disclosures that a registrant provides in response to proposed Item 402(b)(1) may not vary significantly from year to year, since most registrants do not frequently change their compensation philosophy and goals, their decision making process, or the elements of executive compensation

   (i) The fact that the disclosures regarding these topics may not change from year to year does not necessarily mean that the disclosure is boilerplate

e. Possible that changing liability status could have unintended effect of negating benefits of more specific instructions as registrants will tend to be more cautious in drafting disclosure

2. Treatment of CD&A as filed, rather than furnished, disclosure will create challenges in satisfying CEO/CFO certification requirements

   a. Limits on CEO and CFO involvement in the executive compensation process will present practical impediments to certification of many aspects of compensation committee's actions

      (i) May require "sub-certifications" from compensation committee members to verify committee's actions and deliberations

      (ii) Could alter relationship between compensation committee and senior management to the detriment of shareholders

   b. In addition, if CD&A is certified by the CEO and CFO and does not appear over the names of compensation committee members, executives may have a legitimate basis for commenting on and suggesting revisions to the CD&A, which may tend to mute the potential for otherwise robust or candid disclosures

   c. Emphasizing CEO/CFO certification runs counter to current best practices and trends in corporate governance to hold compensation committee (and board of directors) accountable for executive compensation program and decisions

      (i) NYSE corporate governance standards require that compensation committee charter state committee's direct responsibility for producing a compensation committee report on executive officer compensation to be included in a listed company's annual proxy statement or annual report on Form 10-K

3. Should maintain position in Instruction 4 to Item 402(b) that performance target levels reflecting confidential commercial or business information do not have to be disclosed

   a. Proposed Item 402(b)(2)(v) addresses the "specific" items of corporate performance that are taken into account in setting compensation policies and making compensation decisions

      (i) Nonetheless, it appears that the example contemplates a discussion of "general" performance criteria or measures, rather than the precise quantitative or qualitative measure that a registrant has or is planning to use

   b. Final rules should make clear that registrants do not have to potentially disclose strategic or competitive business information in order to satisfy requirements of Item 402(b)(2)

   c. Such a requirement will lead to the use of more generic quantitative and qualitative performance measures

   d. Post-performance period disclosure may not work for many companies, since performance measures are often used for several years

   e. In fact, should consider making it clear that Instruction covers sensitive competitive or strategic information, the disclosure of which would have an adverse effect on the registrant

4. Final rules should specifically call for a discussion of the bases for and factors affecting the named executive officers' compensation

   a. Proposed Item 402(b) does not clearly state that the CD&A is to contain a specific discussion with respect to the factors and criteria upon which the CEO's reported compensation was based

      (i) Assuming this disclosure requirement is not to be scaled back, the requirements for the CD&A should expressly call for that information with respect to the CEO

   b. Proposed rules should also clarify if more detailed information on the specific bases for the compensation of each of the named executive officers is required

   c. However, should also state that specific individual performance assessments are not required for NEOs other than the principal executive officer

(i) Could negatively impact the effectiveness of registrant's senior management by impacting the dynamics between executives, impairing board's ability to develop and implement succession plans, and affecting an executive's effectiveness in dealing with subordinates and with third parties

d. Thus, individualized subjective factors affecting the specific pay decisions for other named executive officers would not be required to the extent they are not based on corporate performance

5. Final rules should encourage disclosure of compensation committee governance practices and processes to be integrated into the CD&A

a. Proposed Item 407(e)(3) would require a narrative description of a registrant's processes and procedures for considering and determining executive and director compensation

b. This requirement should be moved to proposed Item 402(b) or the final rules should make clear that a registrant may instead present this information as part of its CD&A

(i) In recent years, many registrants have begun to discuss their procedures for determining executive compensation in their BCCRs, and the discussion called for by proposed Item 407(e)(3) is closely integrated with the topics to be covered by proposed Item 402(b)

(ii) Combining these discussions is beneficial for investors by providing them in a single location with a description of both the compensation committee's compensation decisions and the process that it utilizes in making those decisions, including the committee's duties and responsibilities and the role of compensation consultants and other advisors

(iii) Moreover, investors are accustomed to locating this information in the BCCR

III. <u>Summary Compensation Table - General</u>

1. The table as proposed does not reflect a consistent approach to when the compensation is measured.

- Some of the items represent amounts awarded and earned during the year – e.g. salary, bonus, perquisites.
- Some items reflect amounts awarded during the year that provide opportunities for future earnings that may or may not actually be realized – e.g. stock awards and option awards.

- Some of the items reflect amounts earned in one year as a result of compensation decisions, and in some cases performance, from prior years – non-stock incentive plan payouts, and to some extent earnings on deferred compensation and some aspects of the increase in pension benefits.

2. Because the table does not truly reflect the compensation that an executive has earned during the particular year, the total of amounts shown in the table should not be used to determine NEOs. The concern is that the determination could be distorted by picking up someone who is not "really" one of the highest paid, and/or increasing the variability of who is in the table as a result of unusual events.

    a. At the very least, the following items should not be used for determining NEOs because they have the potential to distort the deterrmination by picking up someone who is not "really" one of the highest paid:

        - Earnings on deferred compensation and defined contribution SERPs – amounts will be greater for longer-service execs or those who pick better investments.
        - Increase in actuarial value of pension benefits – could have an anomalous amount in the year an exec first becomes eligible for an early retirement subsidy or a higher level SERP benefit, or in some cases due a change in marital status.
        - Severance or similar benefits

    b. Incentive plan payouts and full value of stock/option grants should also not be used since they reflect compensation for past or future years. This could increase the variability of who is in the table.

    c. Salary and current year bonus/incentive may be the most reflective of who are the highest paid in a given year, though it may be appropriate to include the portion of equity award grants attributable to service during a single year, as determined under FAS 123R.

3. For equity awards, the fair value of the award should be reported in the SCT over the service or vesting period of the award, in a manner consistent with FAS 123R.

    a. Equity awards are generally structured as long-term compensation, rewarding the recipient for services over a period of years. Including the full grant date fair value in the table in the year of grant does not reflect cost to the company for the particular year, or the period for which the executive is being compensated.

b. Using the full grant date fair value creates anomalies from executive to executive and from year to year, for example where one executive gets a larger grant that vests over a longer period of time, as might occur with a new hire. .

c. These aspects are of added concern because of the contingent nature of equity awards – they may fail to vest and options may fail to be in the money.

d. Presenting the fair value over the service or vesting period will result in greater between companies that grant larger awards every several years and others that make smaller awards every year.

e. Investors would still have information on the size of equity awards granted in the year because this would be reported in the award grant tables that accompany the SCT.

4. In any event, repricings and modifications should be included in the SCT only to the extent the FAS 123R value of the modified award exceeds the value of the original award.

   a. While repricings are now relatively rare and typically subject to shareholder approval, modifications are not uncommon – e.g. extending the post-termination exercise period of an option.

   b. Including only the incremental value is more representative of the cost to the company and the value to the executive. Reporting the modification as if it was an additional award results in double counting of the same compensation.

   c. It creates a disparity in the treatment of equity and cash incentive awards in that modification or waiver of a performance or other condition of a cash award does not get similar treatment.

5. If it is determined to retain the requirement that 'the aggregate increase in actuarial value" under all defined benefit plans be disclosed under the "All Other Compensation" column of the SCT, the proposal should be revised to describe the basis on which the amount should be determined. We recommend consultation with one or more pension actuaries to develop appropriate instructions describing the amount that should be shown. Among the factors that need to be taken into account are:

   - Whether the amount shown should be an annual amount or the actuarial value of the increase in value of a lump sum amount, and if an annual amount, whether actuarial amounts should be normalized to a standard form of benefit such as a single life annuity commencing at age 65.

- Appropriate interest rate factors
- Appropriate mortality factors
- Whether or not early retirement subsidies or other actuarial subsidies should be shown in the year they apply (which will create a confusing volatility to the numbers shown) or whether they should be deemed to accrue ratably over the service period prior to eligibility (which will require actuarial calculations not normally performed).

IV. <u>Treatment of Bonuses and Incentive Plan Awards</u>

1. The proposed treatment of bonuses and incentive plan awards under various compensation tables is confusing and may not adequately accommodate the variety of such plans. The proposed disclosures are confusing for three reasons:

    - The elimination of the "long-term" element for incentive plan awards eliminates one of the main distinction that has historically resulted in many annual bonus arrangements not appearing in that column;
    - The Proposals use two different terms "incentive plan awards" and "performance-based award," and yet the term "performance-based award" is not defined in the Proposed Rules and the distinction between incentive awards and performance-based awards is not clear;
    - In some cases awards are characterized by whether they are denominated in shares and in some cases they are characterized by whether they are payable in shares (even if the award amount is denominated in dollars); and
    - Performance-based stock awards are in some cases reported in the same column or table with other stock awards and in some cases are reported in the same column or table as non-stock incentive or performance awards.

    Among the anomalies this produces are the following:

    - A performance-based/incentive plan award that is denominated in dollars but settled in stock is not reported in either the Stock Awards column or the Non-Stock Incentive Plan Compensation column of the SCT;
    - A fixed dollar award that is earned if a company's stock price hits a certain target is not reported in either the Stock Awards column or the Non-Stock Incentive Plan Compensation column of the SCT;

- Time-based and performance-based restricted stock awards would be treated differently in the supplementary grant tables to the SCT, but for all other purposes would be treated the same: both would be reported in the same column in the SCT in the year of grant and both would be reported in the Outstanding Equity Awards at Fiscal Year-End table and the Option Exercises and Stock Vested table;
- The treatment of a restricted stock award in the supplementary grant tables to the SCT would differ solely as a result of attaching a minimal performance condition to the grant, as is often done for restricted stock grants in order to qualify those grants for deductibility under Code Section 162(m);
- Grants of options that are exercisable only if the stock price rises by five percent would appear in the Grants of Performance-Based Awards table but grants of options that have value only if the stock price rises are not;
- The extent of information provided on an option that is exercisable only if a performance condition is satisfied is less than that presented for traditional stock options; and
- Some awards in the Grants of Performance-Based Awards table would appear in the SCT in the year of grant and others would not.

2. An alternative approach would be:

    - retain the distinction for "long-term" incentive arrangements; and
    - provide that awards that are denominated in terms of a company's equity should be reported in a consistent manner throughout the compensation tables, regardless of whether such awards have performance conditions, and that all incentive plan awards that are denominated in dollars should be treated the same.

    Under this approach:

    - equity awards that have a performance condition would be reported in the same supplementary grant table as awards of options, SARs, restricted stock and RSUs. This table would apply to all awards denominated in terms of shares of stock; and
    - the "Grants of Performance-Based Awards" table would cover "Grants of Long-Term-Stock Incentive Awards."

3. This alternative approach has the additional benefit of simplifying the proposed Grants of Performance-Based Awards table.

    a. The new table would be organized as follows:

GRANTS OF LONG-TERM INCENTIVE AWARDS

					Estimated Future Payouts		
Name	Number and Type of Award	Dollar Amount of Consideration Paid for Award	Period Until Vesting or Payout	Expiration Date	Threshold	Target	Maximum
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)

b. Under this approach, the definition of "non-stock incentive plan" would be revised to cover "any plan or portion of a plan intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance, stock price or any other performance measure, where the amount payable is not denominated in shares of the registrant's equity securities (regardless of whether amounts earned under the plan may be paid or settled by issuance of registrant equity securities)."

V. <u>Pensions and Deferred Compensation</u>

A. <u>Retirement Plan Potential Annual Payments and Benefits</u>

1. We agree that the current table of actuarial plan benefits rarely provides a clear picture of retirement benefits accrued or payable, and that it should be replaced.

2. The proposed table is likely to provide a confusing array of numbers without a means of comparing benefits from company to company, or even of calculating the actual benefits payable by a single company without more explicit instructions as to what should be shown.

3. We recommend consultation with one or more pension actuaries to provide registrants with a uniform set of guidelines that allows ready determination of (a) the amount payable if the NEO terminated employment as of the last day of the prior fiscal year, and (b) potentially payable if the NEO remains in employment until the normal retirement date under the plan, and in either event provides a reasonable basis for comparing benefits from company to company.

4. All amount should be shown on a consistent actuarial equivalent basis, based on actuarial factors. The amount payable in the form selected could be footnoted, but should not be quantified in the table because

   a. In plans subject to ERISA, the form of benefit cannot be chosen more than 90 days before the benefit commencement date. (It would be possible to show the benefit payable in the plan's default payment mode – usually a single life or joint and survivor annuity, depending on the NEO's marital status, but we do not recommend this, as explained below.)

b. Some plans pay only in a lump sum. It is unclear what amount should be shown in the table for an "annual" retirement benefit when no annual amount is payable.

c. Some plans pay only in annuity form, but offer different types of actuarial equivalent annuities (e.g., with different minimum guaranteed payment periods). Different forms of annuity that are actuarially equivalent can have significantly different annual payment amounts, leading to the impression that benefits are larger or smaller than the benefit payable under the normal form under the plan.

d. The amount shown in the table should be based on the same form for all plans. It would be clearer simply to show payment in the form of a uniform type of annuity, such as a single life annuity beginning at age 65. This is the most common form of annuity to which all other forms of annuity that may be elected under a plan are the actuarial equivalent. Using a single life annuity beginning at age 65 also allows more ready comparison of benefit amounts from company to company. If a particular plan has a different normal retirement date (such as age 62 or age 60 with 10 years of service), this could be footnoted, and the amount payable at the plan's normal retirement date could be shown.

e. We recommend that the table not be required to show the amount payable in the form of a joint and survivor annuity, even though this may be the elected form or the automatic form under a plan.[1] The amount payable in joint and survivor annuity form will vary substantially from executive to executive and potentially from year to year for the same executive, depending on whether the executive is married, and the relative ages of the executive and his or her spouse. We do not believe that there is a legitimate shareholder interest in changes in an executive's marital status, or in the relative ages of an executive and his or her spouse. Therefore we recommend that payments not be required to be disclosed in any form where the annual payment will change depending on the executive's marital status or the age of the executive's spouse.

[1] A joint and survivor annuity is an annuity payable while the participant and his/her spouse are both alive, with a reduced amount (often 50% of the amount payable during the joint lives) payable to the spouse of the participant (if the spouse survives the participant) for the remainder of the spouse's life. This form of annuity (with the surviving spouse of the participant receiving 50% to 100% of the amount payable during their joint lives, depending on the terms of the particular plan) is the automatic form required to be paid to married employees under ERISA, unless appropriate waivers are obtained. This form of annuity is often referred to as a "qualified joint and survivor annuity" or simply QJ&SA.

f. We recommend that the actuarial factors used to calculate estimated retirement benefits be specified in instructions to the table, and that, insofar as possible consistent with appropriate disclosure, the factors specified not require actuaries to perform special calculations for purposes of proxy disclosure. Plans subject to ERISA are required to provide an annual statement of a participant's accrued benefit (the amount payable at normal retirement date if the person terminated employment as of the end of the prior year), and companies with pension plans are required to show an actuarial liability for financial reporting purposes. Requiring the use of the same factors as a company uses for these purposes will avoid requiring the SEC to prescribe interest rate and mortality factors.

5. We recommend that either the amount shown in the table reflect only benefits accrued to date (the amount payable at the plan's normal retirement date if the NEO terminated employment as of the last day of the prior fiscal year) or that the benefits accrued to date and the potential future accruals to the plan's normal retirement date be shown separately, with the potential future accruals including factors for future compensation as well as future service.

   a. The amount accrued to date should be based on service credited under the plan and compensation taken into account under the plan as of the end of the prior fiscal year.

   b. Potential future payments will be amounts that may never be earned, and therefore it is as unrealistic to project them as it is to project option gains based on hypothetical growth factors for company stock. Nevertheless, if potential future benefits are to be shown, the potential future benefits should project not only future service (to age 65 or the maximum number of years of service permitted under the plan) but also future compensation increases (which could be based on the same factors the plan uses for financial accounting purposes). To project future service without projecting compensation changes is to only make a partial estimate of future benefits.

6. Showing estimated early retirement benefits risks overwhelming shareholders with more information than will be reasonably useful in evaluating executive compensation. If benefits are available under any of the plans at a date earlier than the normal retirement date specified in the plan, that fact could be footnoted. If the amount payable at the early retirement date is the actuarial equivalent of the normal retirement benefit (i.e., without actuarial subsidy) then the footnote should be sufficient. If the early retirement benefit is subsidized (i.e., if the reduction for early commencement is less than the actuarial equivalence calculation would dictate) then the footnote could explain the subsidy with a numerical example.

VI. Severance and Change in Control Arrangements

1. The proposals provide for new and detailed narrative disclosures about severance and change of control arrangements, including disclosure of specific dollar amounts of payments that may be made to executives upon termination or a change of control.

2. Narrative disclosure would also be required regarding the specific factors the registrant used to determine the appropriate payment levels.

    - The current disclosure rules do not provide adequate disclosure
    - The proposal is generally on target.

3. The final rules and/or instructions should set forth certain common assumptions that all registrants must use in making these disclosures about payment amounts. This will put all registrants in comparable positions.

    Examples would include:

    - Use of prior fiscal year end salary and bonuses rather than prospective salary and bonuses in making salary and bonus assumptions.
    - Use of prior fiscal year end stock price in making stock price assumptions.

4. The rules and/or instructions should provide that any additional assumptions made by registrants regarding the range of such payments may be general rather than specific to the registrant.

    Examples:

    - Non-competition provisions are appropriately valued.
    - Equity awards or incentive compensation represent reasonable compensation for services to be rendered.
    - Employment arrangements with acquiror represent reasonable compensation for services to be rendered.

5. The rules and/or instructions should provide that registrants may provide a range of potential liability for Section 280G gross-up payments in the case of severance or change of control payments.