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April 10, 2006

Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303
Attn: Nancy M. Morris, Secretary

Re: File No. S7-03-06
Executive Compensation and Related Party Disclosure
(Release No. 33-8655; 34-53185; IC-27218)

Ladies and Gentlemen:

This letter is submitted on behalf of Mercer Human Resource Consulting, Inc. ("Mercer") in response to the Commission's request for comments on Release No. 33-8655 (issued January 27, 2006 and referred to herein as the "Release") regarding proposed amendments to the rules governing the disclosure of information about the compensation of executive officers and directors in proxy and registration statements, as well as certain related matters, including current reports on Form 8-K, beneficial ownership of executive officers and directors, corporate governance disclosure, and related-party transaction disclosure (the "Proposals").

Mercer is a global company providing human resources and related financial advice, products, and services, including compensation consulting services to corporations, boards of directors, and board compensation committees concerning the compensation of executives and directors. Mercer's Human Capital Executive Remuneration Services provides executive compensation consulting services to companies around the globe, including major U.S. publicly-traded companies. Therefore, we have extensive experience designing and implementing executive and director remuneration programs. We understand how compensation committees function and we have assisted countless companies in improving their executive compensation disclosure under the current reporting requirements.

Mercer is a wholly-owned subsidiary of Marsh & McLennan Companies, Inc. The comments and recommendations expressed in this letter reflect the views of Mercer and do not necessarily represent the views of Marsh & McLennan Companies, Inc. or its affiliated companies, or those of our clients.

BACKGROUND

We would like to express our overall support for the Proposals which will undoubtedly enhance the quality of executive officer and director compensation disclosure. Investors are clearly entitled to receive clear, comprehensive, and understandable information about a company's executive and director compensation programs in order to assess whether a company is properly deploying its resources to achieve its stated business objectives. While the Commission's 1992 revisions to its executive compensation disclosure rules represented a landmark change to the presentation of this information, in recent years it has become increasingly clear that these rules needed to be updated to address the disclosure of new and more sophisticated executive compensation arrangements and shifts in the composition of executive pay packages.

While we believe that the Proposals will improve the quality of disclosure and enhance the transparency of the compensation-setting process, they also raise several complex compliance and interpretive issues. Accordingly, we are offering comments on and suggesting changes to several aspects of the Proposals in order to further the Commission's stated objectives. We are also offering recommendations as to where certain specific compensation items should be disclosed. Because executive compensation packages are comprised of a variety of elements that reflect often widely divergent characteristics, to provide investors with truly meaningful information it is important that disclosure requirements be as consistent as possible in the presentation of different pay items. It is our belief that the Summary Compensation Table should focus on what has been currently earned by a company's senior executive officers and that the ancillary tables are the appropriate place to show changes and potential changes in executive wealth accumulation. Thus, our recommendations attempt to reflect this distinction.

For ease of reference, we have organized our comments and recommendations under the following headings:

I. Named Executive Officers

II. Compensation Discussion and Analysis

III. Summary Compensation Table

IV. Supplemental Tables and Narrative to the SCT

V. Post-Employment Payments and Benefits

  A. Retirement Plan Potential Annual Payments and Benefits Table

  B. Nonqualified Defined Contribution and Other Deferred Compensation Plans Table

  C. Severance and Change-in-Control Payments

VI. Director Compensation

VII. Other Proposals

VIII. Transition and Effective Date

I. NAMED EXECUTIVE OFFICERS

1. Determination of most highly-compensated executive officers. We believe that there is value to investors in promoting consistency in identifying a company's named executive officers (the "NEOs") from year to year. There is also value to companies in being able to predict their NEOs with relative certainty. Therefore, we support the Commission's proposal to include a company's principal financial officer (or any individual acting in a similar capacity) as an NEO. However, by requiring that NEO status (other than that of the principal executive officer and the principal financial officer) be determined on the basis of total compensation, the Proposals would make it more difficult to predict and, at the same time, make it considerably more onerous to determine, who will be one of the company's three most highly-compensated executive officers and, thus, an NEO in any given fiscal year. As Commissioner Glassman noted during the Commission's deliberations on the Proposals on January 17, 2006, if adopted, the Proposals would require companies to monitor compensation and estimate the potential value of numerous pay elements for most, if not all, of their executive officers in order to determine each year who, in fact, are the highest paid.

In addition, since under Internal Revenue Code Section 162(m)[1] the term "covered employee" is defined to mean (i) the chief executive officer of the company (or the individual acting in that capacity) as of the close of the taxable year and (ii) the four highest compensated officers for the taxable year (other than the CEO) the total compensation of whom is required to be reported to shareholders under the Securities Exchange Act of 1934, difficulty in predicting its NEOs could impair a company's ability to plan for compliance with Section 162(m).[2]

We believe that these problems stem largely from proposed Item 402(c)(2)(ix), which would consolidate the items that are presently disclosed in the Other Annual Compensation and All Other Compensation columns into a single column and expand the compensation items that must be disclosed. As proposed, the new All Other Compensation column would include all earnings on compensation that is deferred on a basis that is not tax-qualified, including earnings on non-qualified defined contribution plans,[3] contributions or other allocations to all employer-

[1] 26 U.S.C. §162(m).

[2] While we note that the proposed change to the NEO group will further exacerbate the discrepancy between the executive officers who are subject to disclosure under the Commission's rules and the executive officers who are the subject of Section 162(m), we assume that this inconsistency will need to be addressed by Congress through the amendment of Section 162(m)(3)(B).

[3] Proposed Item 402(c)(2)(ix)(B).

sponsored defined contribution plans,[4] and the aggregate increase in the actuarial value of all defined benefit and actuarial pension plans (including supplemental plans) accrued during the covered fiscal year.[5] In our experience, the inclusion of these specific items in the All Other Compensation column would result in anomalies in the total compensation of an individual executive officer in a given fiscal year and, accordingly, lead to significant fluctuations in who is considered an NEO from year to year. Because the benefits reflected by these compensation items are earned over an executive officer's entire career and are a function of several dynamic components (such as compensation increases, actuarial assumptions, deferral participation levels, years of service, and stock market movements), it is difficult to attribute the true value of these arrangements to any given fiscal year. We believe that any valuation approach selected would still result in considerable year-to-year anomalies that would undermine the objectives of relative consistency and predictability in determining the NEO group and comparability of information among companies.

For example, a long-service, second-tier executive officer who has routinely (and voluntarily) participated in his or her company's nonqualified deferred compensation program could generate significant annual earnings on his or her accumulated account balance that would boost his or her total compensation above that of more senior executive officers who did not defer their pay, did so in smaller amounts, or joined the company more recently. Further, because many nonqualified deferred compensation arrangements credit investment earnings based on the return of an equity index or mutual fund (much like the investment options made available to participants in a Section 401(k) plan), there could be substantial changes year to year in the amounts reported due to market volatility. Similarly, anomalies in defined benefit pension plan accruals attributable to the receipt of an unusually large annual bonus, a past service credit at hire, or changes in actuarial assumptions could propel an executive officer into the NEO group, perhaps for a single fiscal year. We do not believe that the fluctuations in a company's NEO group that may result from such unique circumstance benefit investors or leads to more meaningful disclosure.

To promote consistency and flexibility, we recommend that Instruction 1 to proposed Item 402(a)(3) be modified to provide that the determination as to which executive officers are the most highly-compensated be made by reference to total compensation for the last completed fiscal year, but excluding amounts disclosed in the All Other Compensation column of the

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[4] Proposed Item 402(c)(2)(ix)(F).

[5] Proposed Item 402(c)(2)(ix)(G).

Summary Compensation Table. In other words, the determination of a company's most highly-compensated executive officers (other than the principal executive officer and the principal financial officer) would be based on the amounts disclosed solely in the Salary, Bonus, Stock Awards, Option Awards, and Non-Stock Incentive Plan Compensation columns of the Summary Compensation Table.[6]

Alternatively, if the Commission agrees with our later recommendations (which are described in Section III.4(e) and (f) below) for modifying the requirements with respect to the disclosure of investment earnings and the calculation of defined benefit pension plan values that must be disclosed in the All Other Compensation column, we would withdraw our objection to the inclusion of this column when determining a company's most highly- compensated executive officers.

II. COMPENSATION DISCUSSION AND ANALYSIS

1. Replacement of BCCR. We support the Commission's effort to rejuvenate the discussion of a company's compensation philosophy, policies, and practices by replacing the current Board Compensation Committee Report ("BCCR") with the new Compensation Discussion and Analysis ("CD&A"). While we believe that the BCCRs of most major companies have evolved over the years and today many provide investors with detailed and informative discussions of their executive compensation programs, companies would benefit from additional guidance on what should be addressed in these reports. Thus, we believe that the requirements of proposed Item 402(b)(1), as well as the examples provided in proposed Item 402(b)(2), will serve as an informative "roadmap" for compensation committees when drafting the CD&A. Based on our experience, compensation committees will likely produce much more robust discussions of their executive compensation programs as a result of being provided such a roadmap. In addition, we expect that they will be more engaged in the process of preparing the CD&A than has generally been the case with the BCCR and that, in turn, is likely to reduce the amount of "boilerplate" disclosure.

We also concur with the Commission's proposal to require that the CD&A (as well as the other disclosure required by proposed Item 402) be provided in plain English. We believe that both the form and content of the CD&A will be enhanced by this requirement. We further believe

[6] While we recognize that concerns have been expressed by some observers about including long-term incentive compensation in the determination of a company's most highly-compensated executive officers, we believe that the importance and wide-spread use of long-term incentives make it a necessary component when determining the NEO group.

that the plain English requirement should be extended to the entire proxy statement (or information statement, as the case may be). In recent years, the increase in the number of subjects that must be addressed in proxy and information statements has led to longer and, at times, dense disclosure. We believe that investors would benefit significantly from a more readable, accessible document and that, while many companies would certainly experience challenges in transitioning to a plain English format, they would ultimately benefit from the clearer communication with their shareholders and the marketplace.

2. Retain as committee report. We recommend that the Commission retain the current requirement in Item 402(k)(3) that the CD&A be made over the name of each member of the company's compensation committee (or, in the absence of a compensation committee, the board committee performing equivalent functions or the entire board of directors). As the Commission is aware, recent corporate governance reforms have been intended to hold the compensation committee of the board of directors accountable for the company's executive compensation program. In fact, the corporate governance listing standards of The New York Stock Exchange require that each listed company maintain a charter for its compensation committee that, among other things, expressly provides that the compensation committee has direct responsibility to produce a compensation committee report on executive officer compensation as required by the Commission to be included in the listed company's annual proxy statement or annual report on Form 10-K.[7] We do not believe that it is in the best interests of investors to suggest that the CD&A is any less a report of the compensation committee than the BCCR.

In addition, the Proposals, as presently structured, implicitly put a company's management in charge of preparing the CD&A. We believe that this creates the appearance of, if not in fact, a conflict of interest. A typical CD&A will discuss a company's compensation philosophy, rationale, and outcomes, as well as the compensation committee's decision-making process. Since, in the case of the former, management will be the beneficiaries of these decisions, it would be incongruous to have them be responsible for the collection and presentation of this information. In the case of the latter, management is not privy to this process and will have, at best, only indirect access to the information that will form the basis of this disclosure. Thus, we do not see how the proposed approach will lead to improved disclosure or benefit investors. While we acknowledge that it may be important to ensure that both management and the board of directors are familiar with and support the disclosure in the CD&A, this should not be achieved at the expense of the compensation committee's ownership of the discussion.

[7] See Section 303A5(b)(i)(C) of the NYSE Corporate Governance Rules.

3. "Filed" vs. "furnished" status. We do not agree with the Commission's decision to withhold "furnished" status from the CD&A because of a perceived failure on the part of companies to provide the type of open and robust discussion in BCCRs that such status was supposed to facilitate. As noted above, in our experience most large companies now provide BCCRs that provide investors with the type of discussions that the Commission contemplated when it adopted the current disclosure rules in 1992. In our view, the overall quality (or lack thereof) of BCCRs has resulted from the absence of guidance on what topics should be discussed, a problem that is largely remedied by the Proposals.

Nonetheless, we do not object to the Commission's proposal to treat the CD&A as "filed" for federal securities law purposes and consider it a part of the proxy statement and any other filing in which it is included, with one modification. We believe that the CD&A should not be considered part of a company's annual report on Form 10-K or 10-KSB for purposes of the certification requirements of Exchange Act Rules 13a-14 and 15d-14. In our view, a company's principal executive officer and principal financial officer will not be able to certify as to the portions of the CD&A that involve their own compensation. Further, the Proposals potentially create a conflict of interest by essentially inserting the CEO and CFO into the compensation committee's decision-making process. In order for these executive officers to be able to certify as to the accuracy and completeness of the CD&A, they would have to be confident as to the accuracy and completeness of the description of the process, and rationale behind the various compensation elements, and so forth. The degree of involvement of these executive officers in the compensation-setting process that would be required to make these determinations would run counter to the corporate governance best practices and the listing standards of the self-regulatory organizations. In fact, virtually all of the other regulations governing executive compensation provide for the *independence* of the compensation committee in making compensation decisions for senior executives.

4. Period covered. We recommend that proposed Item 402(b)(1) be modified to make it clear that the CD&A need only discuss the compensation awarded to, earned by, or paid to the named executive officers during the last completed fiscal year. Current Item 402(k) expressly provides that the BCCR need only cover compensation policies and decisions for the last completed fiscal year. While we believe that the Commission intends for the CD&A to cover the same period, the absence of a reference to the time period to be covered by the discussion creates an ambiguity that should be clarified.

In addition, because many decisions with respect to compensation paid for the last completed fiscal year are made after year-end, we recommend that the Commission make clear that such decisions, to the extent that they relate to the compensation awarded to, earned by, or paid to the named executive officers during the last completed fiscal year, must be addressed in the CD&A. While this should be obvious to most companies, such a clarification would eliminate any potential misinterpretation or manipulation of the final rules.

5. Specific compensation discussions. We recommend that the Commission clarify whether the CD&A must discuss the specific bases for the compensation decisions for each NEO. While the Release indicates that the CD&A should be sufficiently precise to identify material differences in compensation policies and decisions for individual NEOs where appropriate,[8] it goes on to provide that where the policy for an executive officer is materially different, for example in the case of a principal executive officer, his or her compensation would be discussed separately. Because this latter provision speaks only in terms of *policies,* rather than *decisions,* it is unclear whether the discussion must address the specific bases for each NEO's compensation for the last completed fiscal year, including the factors and criteria upon which such compensation was based.[9]

If it is the Commission's intention that the CD&A address the specific bases for each NEO's compensation, we recommend that this requirement be limited to the principal executive officer or, at most, the principal executive officer and the principal financial officer. We believe that requiring a discussion of the specific bases for the compensation of each NEO would unnecessarily lengthen the CD&A without providing meaningful information for investors. Moreover, such a discussion could create internal morale problems for a company that could undermine the cohesion of its management team. Most, if not all, of the compensation decisions for executive officers are made with the input of the principal executive officer and/or each executive officer's immediate supervisor. It would be detrimental to the company to have the individual compensation decisions relating to these executive officers, many of whom are peers, publicly disclosed. This potential problem is exacerbated under the Proposals where the NEOs in any given year could fluctuate significantly depending on their total compensation.

6. Tax and accounting implications. Proposed Item 402(b)(2) provides several examples of the type of material information that may be disclosed in the CD&A, including the impact of the accounting and tax treatment of particular forms of compensation.[10] We recommend that the

[8] The Release further states that where policies and decisions are materially similar, NEOs may be grouped together.

[9] Such a discussion would be similar to the discussion currently required under Item 402(k)(3) with respect to the compensation of the chief executive officer.

Commission make clear that this example contemplates a discussion of the consequences of the tax and accounting treatment on the company (for example, the impact of Section 162(m)) and not the consequences to the NEOs (for example, the federal income tax consequences of receiving a particular form of compensation).

7. Performance metrics. Proposed Item 402(b)(2) provides several examples of the type of material information that may be disclosed in the CD&A, including the specific items of corporate performance that are taken into account in setting compensation policies and making compensation decisions,[11] how specific forms of compensation are structured to reflect the NEO's individual performance and/or individual contribution to these items of the company's performance (describing the elements of individual performance and/or contribution that are taken into account),[12] and how specific forms of compensation are structured to reflect these items of the company's performance.[13]

We are aware that some parties have expressed a desire for the final rules to require more explicit disclosure regarding the performance metrics and targets underlying annual and long-term incentive arrangements than are even contemplated by these Proposals. In our experience, however, many companies legitimately believe that disclosing even the performance metric or metrics for a specific compensation arrangement (for example, new product revenue growth) would reveal proprietary business information that could be useful to competitors. Some of the proponents for greater disclosure have attempted to assuage this concern by proposing that, where such a concern exists, the performance metric or metrics be disclosed after the performance period has been completed, when, presumably, there is no longer such a risk. While this approach is appealing, it is not always true. Companies rarely use a performance measure for a single year or plan cycle. Compensation committees select measures, in part, because of their relevance to the company's business strategy over an extended period of years. Therefore, it may be problematic to disclose the goals even after the fact.

Of course, in many cases the performance measures do not provide insight into a company's confidential business strategy. In those cases, we would expect a company to be willing to disclose this information. We are concerned, however, that if the final rules place too great an

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[10] Proposed Item 402(b)(2)(x).

[11] Proposed Item 402(b)(2)(v).

[12] Proposed Item 402(b)(2)(vi).

[13] Proposed Item 402(b)(2)(vii).

emphasis on the disclosure of performance measures, companies will begin to move away from business or industry-specific measures and, instead, revert to so-called "plain vanilla" measures, such as earnings-per-share. While this might satisfy investors who must know all of the details, it may ultimately lead to "one-size-fits-all" incentive plans that are poorly aligned with sound business strategy. If this were to happen, it would be an unfortunate step backwards in executive compensation.

Given this tension between investors' desire for greater transparency about the pay-for-performance relationship and companies' understandable reluctance to disclose sensitive confidential or proprietary information, an alternate solution is needed. We believe that, in large part, investor interest in detailed pay-for-performance disclosure stems less from a desire to independently validate the performance measures and target levels set by the compensation committee than a desire to ensure that the committee does not change these measures or targets once they have been established. In our view, this concern can be adequately addressed by simply requiring companies to disclose when the compensation committee has modified, revised, or otherwise altered performance measures or target levels or exercised its discretion to waive any such items. This requirement should be a sufficient deterrent to discourage this behavior unless the committee has a compelling rationale for the change.

8. <u>Retirement payments and benefits policies.</u> We believe that the Commission should modify proposed Item 402(b)(2) to add to the list of specific items as possibly material information a company's policies with respect to establishing and maintaining the competitive positioning of its executive retirement benefits, including its defined benefit pension plans and nonqualified deferred compensation program. Because retirement benefits can comprise a significant portion of an individual's total compensation during their service as an executive officer, we believe that this information would be of interest to investors. Consequently, we believe that it should be added to the list as an issue that it may be appropriate for the company to address in its CD&A.

9. <u>Compensation-related policies</u>. Proposed Item 402(b)(2) provides several examples of the type of material information that may be disclosed in the CD&A, including a company's equity or security ownership requirements or guidelines and any company policies regarding hedging the economic risk of such ownership.[14] Because these are not the only compensation-related policies that are of interest to investors, we recommend that the Commission modify proposed

[14] Proposed Item 402(b)(2)(xi).

Item 402(b)(2)(xi) to cover other significant policies, such as insider trading and compensation recovery policies.[15]

10. Discussion of compensation-setting process. We note that, under proposed Item 407(e) (which addresses disclosure of a company's corporate governance structure), a company would be required to provide a narrative description of the compensation committee's processes and procedures for considering and determining executive and director compensation, including the scope of authority of the compensation committee (and the extent to which the committee may delegate any of its authority), the role of executive officers in determining or recommending an amount or form of executive and director compensation, and certain information about any compensation consultant in the compensation-setting process.

While we recognize that the Commission intends for this information to be presented as part of a company's overall corporate governance disclosure, we believe that investors would better benefit if this information could be presented as part of its CD&A. In recent years, many companies have begun to address their process for determining specific executive compensation levels and awards in their Board Compensation Committee Reports. They have also begun to identify the advisors who assist them in this process, including any compensation consultants, and to describe the advisor's relationship with and role to the committee. We believe that this practice has merit, as it provides investors in a single location with an explanation of the compensation committee's actions and decisions and the process that it employed in making those decisions. It also implicitly communicates to investors the committee's acknowledgment of its duties and responsibilities and provides a detailed summary of how they were carried out. We recommend that the Commission expressly permit companies to continue to address this subject as part of the CD&A.

11. Performance graph. We support the Commission's decision to eliminate the peer performance graph currently required by Item 402(l). However, since we expect that some companies may want to continue to provide such information for investors, we recommend that the Commission make clear that (i) companies that elect to include such a graph in support of the CD&A should apply the disclosure requirements of current Item 402(l) (and its related Staff interpretations) to avoid distortion and/or manipulation and (ii) the performance graph will be considered "furnished" rather than "filed" for liability purposes.

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[15] For example, policies that require that certain compensation be returned to the company in the event that the employee violates a non-compete restriction or require the return of performance-based compensation in the event of a financial restatement.

III. SUMMARY COMPENSATION TABLE

We understand and appreciate investors' desire for an annualized total compensation figure. As executive compensation packages have become more sophisticated, it has become increasingly difficult for investors to ascertain the potential size of these packages and to evaluate their individual components. As the centerpiece of a company's executive compensation disclosure, it is clearly appropriate for the Commission to revise the form and content of the Summary Compensation Table to ensure that it achieves its original purpose of providing investors "a concise, comprehensive overview" of executive compensation.

However, we are concerned that, as currently formulated, proposed Item 402(c) will not achieve the Commission's objectives. We believe that, to make the information in the Summary Compensation Table truly meaningful to investors, the various compensation elements reported in the table should be presented on a consistent basis or combined only with similar elements.

As proposed, the proposed Total Compensation column in the Summary Compensation Table would add together several compensation elements that, because they are measured at different times, are essentially not equivalent. We believe that combining these elements in a single column will lead to misinterpretations of the information and, ultimately, investor confusion. In addition, because several of the table's columns would report amounts that have not been earned, but that could potentially be earned in the future, to the extent that these elements are subject to further disclosure (as is the case with restricted stock and stock options), we fear that they may be "double-counted" by investors.

Proposed Item 402(c)(2) would require disclosure of (i) the dollar value of base salary (cash and non-cash) *earned* during the fiscal year covered,[16] (ii) the dollar value of bonus (cash and non-cash) *earned* during the fiscal year covered,[17] (iii) the aggregate *grant date fair value* of stock awards (including restricted stock, restricted stock units, performance shares, phantom stock, phantom stock units, common stock equivalent units, and other similar instruments that do not have option-like features),[18] (iv) the aggregate *grant date fair value* of stock option awards (including tandem SARs, freestanding SARs, and other similar instruments with option-like

[16] Proposed Item 402(c)(2)(iv).

[17] Proposed Item 402(c)(2)(v).

[18] Proposed Item 402(c)(2)(vi).

features),[19] (v) the dollar value of all *earnings* pursuant to awards under non-stock incentive plans (even though *not paid out* until a subsequent year),[20] and (vi) all other compensation that could not be properly reported in any of the previous categories (including amounts *accrued* under defined benefit pension plans and nonqualified deferred compensation plans).[21]

Thus, the Summary Compensation Table would mix *earned* compensation (such as salary and bonus) that is actually received during a covered fiscal year with *awarded* compensation (such as restricted stock and stock options) that may or may not eventually be earned and realized. Further, in some instances, the timing of disclosure (and, in some instances, the amount disclosed) would be determined entirely by the award's form (cash or stock).

For example, it is our understanding that a long-term performance-based incentive award that is payable in cash would be reported in the Summary Compensation Table in the year earned (even if the award was not paid in that year). On the other hand, if the award was payable in stock (or, at the election of the company, in either cash or stock) the award would be reported in the table in the year granted. Moreover, given the broad scope of the Non-Stock Incentive Plan Compensation column, the reporting of non-stock incentive plan awards would differ depending on each individual award's terms. For example, in some instances an award would be reported when earned and paid out (in the case of an award with a single year performance period), while in others the award would be reported when the relevant performance measure was satisfied even though not payable until a later date and subject to forfeiture conditions.

Because we are concerned that the presentation formulation of the Summary Compensation Table would distort and potentially misrepresent the compensation actually earned and received by the NEOs, we recommend that the Commission make the following modifications to proposed Item 402(c).

1. <u>Clarify distinction between bonuses and non-stock incentive plan compensation.</u> Proposed Item 402(c)(2)(v) would require the disclosure of the dollar value of bonus (cash and non-cash) earned during the fiscal year covered in column (e) of the table. Proposed Item 402(c)(2)(viii) would require the disclosure of the dollar value of all earnings for services performed during the

[19] Proposed Item 402(c)(2)(vii).

[20] Proposed Item 402(c)(2)(viii).

[21] Proposed Item 402(c)(2)(ix)(B) and (G).

fiscal year pursuant to awards under non-stock incentive plans in column (h) of the table. Because the proposed definition of a "non-stock incentive plan" in Instruction 6 to proposed Item 402(a)(3) does not address the duration of the plan, it is possible that compensation earned under some non-stock incentive plans could be reportable in column (e) of the Summary Compensation Table and, conversely, that compensation earned as a bonus could be reportable in column (h) of the table.[22]

Proposed Item 402(a)(6)(iii) defines the term "incentive plan" to mean any plan providing compensation intended to serve as an incentive for performance to occur over a specified period, whether such performance is measured by reference to the financial performance of the company or an affiliate, the company's stock price, or any other performance measure.[23] Because this definition does not indicate the duration of the period over which the relevant performance metric is measured,[24] the performance period could be as short as one year, leading to possible confusion in determining whether to report certain types of compensation arrangements as annual bonuses in column (e) or as non-stock incentive plan awards in column (h).

Thus, we recommend that the Commission clarify when compensation that is earned over a one-year period is to be reported as a bonus and when it is to be reported as a non-stock incentive plan award. For example, the Commission could simply restore the one-year distinction of the current rules. Under this formulation, compensation that is payable for a performance period of one year or less would be reported as a bonus in column (e) of the Summary Compensation Table, while compensation that is payable for a performance period of more than one year would be reported in column (h) of the table.[25] Alternatively, the determining factor could be whether compensation payable for a one-year period is performance-based (with such arrangements deemed non-stock incentive plans awards and all other arrangements treated as bonuses) or whether the performance measures are pre-established or subjectively evaluated at the end of the year.

[22] Additionally, this ambiguity raises questions as to whether some types of bonus compensation would be considered a performance-based award subject to disclosure in the Grants of Performance-based Awards Table of proposed Item 402(d).

[23] Similarly, proposed Item 402(a)(6)(iii) defines the term "non-stock incentive plan" to mean an incentive plan or portion of an incentive plan where the relevant performance measure is not based on the price of the company's equity securities or the award does not permit settlement by issuance of company equity securities.

[24] And, thus, differs from the definition of a "long-term incentive plan" under current Item 402(a)(7)(iii).

[25] Where a non-stock incentive plan award contained a multi-year performance measure that measured performance and fixed award amounts in annual increments, we would recommend that these amounts be reported in column (h) of the table, as originally proposed.

2. Disclose target dollar opportunity of non-stock incentive plans awards at grant. As previously noted, proposed Item 402(c)(2)(viii) would require the disclosure of the dollar value of all earnings for services performed during the fiscal year pursuant to awards under non-stock incentive plans as earned, even if not payable until a later year and even if subject to forfeiture conditions. Because non-stock incentive plan awards take a variety of forms, they are not as easily categorized as other compensation elements. Although the reporting of these awards as the performance measures are satisfied would appear to be consistent with the reporting of salary and bonus amounts, because they are often subject to forfeiture conditions (such as continued service-based vesting), they would not the economic equivalent of salary and bonus at the time of disclosure. Further, the reporting of these awards differs from that of stock awards and option awards, which are to be shown at their grant date fair values.

To promote consistency in the reporting of all long-term incentive compensation, we recommend that the Commission modify proposed Item 402(c)(2)(viii) to provide for the reporting of non-stock incentive plan awards in the Summary Compensation Table on a grant date basis, similar to the approach proposed for stock and option awards. Thus, the amount reported for an individual award would be the dollar value of the estimated payout opportunity determined as of the grant date of the award. Where an award was subject to a range of estimated payouts, the amount reported would be the dollar value of the estimated payout at target.[26]

To further the consistent reporting of long-term incentive compensation, we recommend the commission modify proposed Item 402(h), the Option Exercises and Stock Vested Table, to add an additional column that would report the dollar value of the actual payouts of the non-stock incentive plan awards previously disclosed in the Summary Compensation Table. Similarly, proposed Item 402(h)(2)(iv) could be modified to require that target amount previously reported in the Summary Compensation Table be disclosed in column (d). This would ensure that investors would have a complete picture of the amounts that the named executive officers realized from these awards.

3. Replace Total Compensation column with two columns. To facilitate consistent disclosure and to minimize investor confusion, we recommend that the Commission modify proposed Item 402(c)(2)(iii) to replace the proposed single Total Compensation column with two columns. The first, an Earned Compensation column, would include the compensation that an NEO has actually earned and received in the covered fiscal year. Thus, the amount disclosed in this column would reflect the total of the amounts reported in the proposed columns titled Salary,

[26] In the case of performance share awards disclosable in the Stock Awards column of the Summary Compensation Table, a similar approach should be used.

Bonus, and All Other Compensation. The second, a Contingent Compensation column, would include the compensation that will change in value, or may never be realized, depending on the satisfaction of future contingencies. Thus, the amount disclosed in this column would reflect the total of the amounts reported in the proposed columns titled Stock Awards, Option Awards, and Non-Stock Incentive Plan Compensation (as modified by our recommendation in Section III.2 above). The immediate advantage of this approach is that companies would not be required to aggregate disparate compensation elements into a single total, but would be permitted to combine like elements to produce separate total figures that acknowledge the differences in the presentation of these amounts in the Summary Compensation Table. Such an approach would not disadvantage investors who would be able to add these two columns together if they wished to produce a single total compensation figure.

While some observers have suggested that presentation of two Summary Compensation Tables – one for amounts earned and one for amounts potentially to be earned, we believe that such an approach would be cumbersome, require duplicate disclosure of some compensation elements and, ultimately, confusing to investors.

4. Additional comments on SCT. In addition to the foregoing, we have the following additional comments on certain aspects of the proposed Summary Compensation Table.

(a) Non-stock incentive plan awards. Even if the Commission does not agree with our recommendations in Section III.1 and 2 above, we would still recommend that proposed Item 402(c)(2)(viii) be modified to provide that only compensation payable for a performance period of more than one year be reported in column (h) of the Summary Compensation Table. While non-stock incentive awards are not limited to arrangements with durations of more than one year, we believe that the majority of these awards have terms that extend beyond one year. (In our view, a non-stock incentive award with a duration of one year or less is tantamount to an annual incentive arrangement and should be disclosed in the Bonus column of the Summary Compensation Table.) As proposed, non-stock incentive plan awards with a multi-year performance measure would be disclosed as soon as the performance measure was satisfied, even though the amounts may not be paid until a later year and, if subject to further contingencies (such as a service-based vesting requirement), may not be payable at all.

Because this may lead to the reporting of amounts that an NEO may never receive, we recommend that the Commission modify proposed Item 402(c)(2)(viii) to require disclosure only as award amounts are earned (where subject to no further contingencies) or paid out (where subject to further contingencies at the time of earning). For example, where the amount payable under an award (if any) will be determined based on satisfaction of a specified revenue growth target at the completion of a three-year period ending December 31, 2007 and payment is subject to continued employment for an additional two-year period ending December 31, 2009, the award should not be disclosed in the Summary Compensation Table until it is paid out.

(b) Modified awards. Instruction 2 to proposed Items 402(c)(2)(vi) and (vii) provides that if a company has adjusted or amended the exercise price of stock options or SARs previously awarded to an NEO, whether through amendment, cancellation, or replacement grants, or any other means, or otherwise has materially modified such awards, the company must include, as an award required to be reported in the Option Awards column, the total fair value of the options or SARs as repriced or modified, measured as of the repricing or modification date.

We believe that this requirement is unduly punitive. While such treatment may be appropriate for an option or SAR repricing, it is entirely inappropriate for most other types of modifications. The inclusion of the full fair value amount will be distortive of the affected NEOs actual compensation for the covered fiscal year. In addition, in could create an anomaly in the covered fiscal year for purposes of determining the NEO group.

We recommend that the Commission modify this instruction to require that only the incremental increase in the fair value of the repriced or modified stock right (if any) as calculated for purposes of SFAS 123(R), and not the full recalculated fair value, be treated as a new option or SAR grant and included in the Option Awards column of the Summary Compensation Table.

(c) Earnings on outstanding awards. We agree with the Commission's proposal to require disclosure of all earnings (such as dividends and dividend equivalents) paid on outstanding stock and option awards and non-stock incentive plan compensation. Such amounts are clearly compensatory and should be included in the Summary Compensation Table. However, we do not agree with the Commission's proposal to aggregate these amounts with the disclosable value of stock and options awards made during the covered fiscal year and then identify and quantify such earnings in a footnote to their respective column.[27] Instead, we recommend that the Commission modify proposed Item 402(c)(2)(ix) to require that such earnings be included in the All Other Compensation column of the Summary Compensation Table.[28] To ensure that these amounts are clearly identified, we would further recommend that the Commission modify

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[27] Instruction 3 to proposed Items 402(c)(2)(vi) and (vii).

[28] This recommendation would extend to earnings paid or payable on outstanding non-stock incentive plan awards as well.

Instruction 3 to proposed Item 402(c)(2)(ix) to exclude such earnings from the minimum $10,000 threshold for separate identification and quantification.

(d) Tabular disclosure of All Other Compensation information. Because most companies are likely to report several different types of compensation in the All Other Compensation column of the Summary Compensation Table, we believe that this disclosure would be improved by requiring companies to supplement the amount reflected in this column with a table similar to that set forth on page 54 of the Release. Such a table should require itemized disclosure of each compensation item exceeding $10,000 in value, with any items below that threshold being combined into a single column at the far right of the table.

(e) Investment earnings on nonqualified deferred compensation. We do not agree with the Commission's proposal to require disclosure of all investment earnings on nonqualified deferred compensation and nonqualified defined contribution plans in the All Other Compensation column of the Summary Compensation Table. In our view, such earnings represent the wealth creation of an NEO over his or her entire career, rather than compensation that is comparable to the other elements that are to be disclosed In the Summary Compensation Table. In addition, as illustrated on page six of the attached article, there is the potential for significant annual volatility in the amounts reported given that the majority of these arrangements use a variable investment earnings rate that is based upon an array of mutual funds (and which, in many cases, matches the investment choices in the company's tax-qualified Section 401(k) plan). Consequently, positive changes in these earnings in a given fiscal year could easily overshadow the amounts earned or awarded from other compensation elements, while negative changes could have the peculiar effect of offsetting an NEO's other compensation.

While we agree that such investment earnings should be reported, we believe that it would be preferable to include this information as part of a revised Nonqualified Defined Contribution and Other Deferred Compensation Plans Table as discussed in Section V.B below. Such an approach would not undermine the integrity of the Summary Compensation Table and would provide more clarity for investors seeking to understand the scope and magnitude of a company's nonqualified deferred compensation obligations. It would also afford investors the ability to make clearer and more direct comparisons of these amounts between NEOs and between companies. Consequently, we recommend that the Commission withdraw proposed Item 402(c)(2)(ix)(B) from the Summary Compensation Table.

If, however, the Commission decides to retain proposed Item 402(c)(2)(ix)(B), then we recommend that the disclosure requirements distinguish between investment earnings on elective deferrals and investment earnings on company contributions. Elective deferrals reflect a personal investment decision of an NEO. Since he or she could have received the compensation that has been electively deferred and invested it privately without incurring a disclosure obligation, requiring the disclosure of these amounts in the Summary Compensation Table (and, correspondingly, in the determination of the NEO group) results in disparate treatment of two otherwise similarly situated executive officers. We believe that disclosure of investment earnings on elective deferrals should be required only to the extent that such earnings are paid at "above-market" or "preferential" rates.

Thus, if the Commission does not agree with our recommendation to withdraw proposed Item 402(c)(2)(ix)(B), then we recommend that it modify the proposed item to:

(a) limit the disclosure of investment earnings on nonqualified deferred compensation plans for both elective deferrals and company contributions to amounts representing "above-market" earnings;

(b) require that, for these purposes, "above-market" earnings would be defined as currently provided in Instruction 3 to Item 402(b)(2)(iii)(C); and

(c) require the disclosure of company contributions on tax-qualified defined contribution plans in order to be consistent with the proposal to include the aggregate increase in the actuarial value of both tax-qualified and nonqualified defined benefit pension plans.

(f) <u>Pension plan actuarial values.</u> We do not agree with the Commission's proposal to require the disclosure of the aggregate increase in the actuarial value of all defined benefit and actuarial pension plans accrued during the company's covered fiscal year in the All Other Compensation column of the Summary Compensation Table. As is the case with investment earnings on nonqualified deferred compensation arrangements, this item represents the wealth creation of an NEO over his or her entire career that is a function of several dynamic components, rather than compensation that is comparable to the other elements that are to be disclosed In the Summary Compensation Table. As illustrated on pages four and five of the attached article, there is the potential for significant annual volatility in the amounts reported. Consequently, changes in the values of this benefit could easily overshadow the income from other compensation elements.

While we agree that pension value increase should be reported, we believe that it would be preferable to include this information as part of a revised Retirement Plan Potential Annual

Payments and Benefits Table as discussed in Section V.A below. Consequently, we recommend that the Commission withdraw proposed Item 402(c)(2)(ix)(G) from the Summary Compensation Table.

If, however, the Commission decides to retain Item 402(c)(2)(ix)(G), then we recommend that further guidance be provided as to how companies should calculate the aggregate increase in the actuarial value of defined benefit and actuarial pension plans for purposes of the Summary Compensation Table. We believe that the following approach, which highlights the increase in the defined benefit accrued during the year by an NEO, provides the most useful information for investors.

Under this approach, a company would:

- compare the estimated annual benefit that an NEO would receive at normal retirement age as of the end of the most recent fiscal year under all defined benefit and actuarial pension plans with the estimated annual benefit that the NEO would receive as of the beginning of that year (essentially, the estimated annual benefit as of the end of the preceding fiscal year);
- take the resulting incremental increase in value (if any) and determine the present value of this amount at normal retirement age using reasonable actuarial assumptions; and
- discount the resulting amount to its current present value.

This approach can be illustrated by the following example:

At the beginning of the last completed fiscal year, a 55 year-old NEO was to receive at normal retirement age (65) an estimated annual benefit of $1,000,000 per year. At the end of the last completed fiscal year, the value of this estimated annual benefit had increased to $1,200,000. To determine the increase in the actuarial value of the benefit for disclosure purposes, a company would multiply the incremental increase in the estimated annual benefit ($200,000) by the NEO's actuarially-determined present value factor at age 65 (for example, a factor of 10 using reasonable assumptions) to arrive at an aggregate benefit increase of $2,000,000. This amount would then be discounted to the NEO's current age (using a reasonable interest rate) and the result would be disclosed in the All Other Compensation column. In this example, the discounted present value from age 65 to age 55 using a 6% interest rate is $1,117,000 [($2,000,000) x 1.06^(-10)].[29]

By applying this approach, the disclosure would exclude the interest component of the present value of the defined benefit pension plan benefit. This would enable investors to ascertain the actual defined benefit earned by the NEOs by eliminating the interest component. In our opinion, this interest component represents wealth accumulation, rather than compensation earned, and, thus, should not be part of this particular disclosure. In addition, excluding the interest component would eliminate the potential for negative values in a given year (due to an increase in the discount rates) that would potentially create other issues, such as whether a negative value must be disclosed and/or combined with other income items in the All Other Compensation column when determining the total amount to be reported. If this approach is adopted for defined benefit pension plans, the reported values for defined contributions plans should be modified to only report the annual contributions (and not earnings unless "above-market") to be consistent with this treatment.

We also recommend that the Commission specify in the final rules the permissible assumptions and methods that should be used for calculating the disclosable increase in defined benefit pension plan values. In this regard, we would recommend that the Commission advise companies to estimate the annual increase in pension values with the stated goal of minimizing any large "spikes" in value due to an earlier (or later) retirement than originally assumed or restatements of unrealistic prior actuarial assumptions. This would involve making realistic assumptions as to assumed retirement age, but using actuarial assumptions – such as discount rate, mortality, and lump sum interest rates – that are consistent with the assumptions used by the company in preparing its financial statement to the extent appropriate.[30] The assumed retirement age in many cases will likely equal the plan's earliest unreduced retirement age, unless a contractually-specified retirement age is exists.

We would not recommend attempting to develop an individualized allocation of the aggregate accounting for each NEO because the assumptions used for determining the aggregate

[29] Thus, using this approach, the formula for determining the increase in the actuarial value would be [end of year age 65 annual income] - [beginning of year age 65 annual income] x [age 65 annuity factor] x [factor discounting to current age].

[30] The supplemental narrative to be required by proposed Item 402(f)(1)(v) would be used to explain how the disclosed amounts were derived, the assumptions, used, and the applicable rationale for the approach used.

accounting cost of a defined benefit pension plan are typically established on a group, rather than on an individualized, basis. This approach produces a number that is unrelated to an NEO's actual benefits and could produce values significantly different than what the NEO will actually receive.

(g) Tabular disclosure of perquisites. As in the case of compensation to be disclosed in the All Other Compensation column, we recommend that the Commission require that perquisites and other personal benefits provided to the NEOs be disclosed in a tabular format. We also recommend that all perquisites and personal benefits be quantified for purposes of this disclosure (not just the items that are valued at the greater of $25,000 or 10% of total perquisites and other personal benefits, as proposed).

(h) Valuation of perquisites. We believe that investors cannot obtain a full understanding of the perquisite amounts disclosed in the Summary Compensation Table without knowing the methodologies that are used to calculate the disclosable amounts. Consequently, we recommend that the Commission require companies to describe the valuation methodology used to determine the disclosable value of its most significant perquisites. To keep such a requirement from becoming an undue burden and to avoid extraneous disclosure, we recommend that the reporting threshold for this item be limited to perquisites or other personal benefits exceeding $50,000 in value.

(i) Distributions of nonqualified deferred compensation. We recommend that the Commission make clear in the final rules that a distribution of nonqualified deferred compensation does not represent compensation that must be disclosed in the All Other Compensation column of the Summary Compensation Table. Because Instruction 4 to proposed Item 402(c) would require that amounts deferred at the elect of an NEO or the direction of the company would be included in the appropriate column for the fiscal year in which earned, proposed Item 402(c)(2)(ix)(F) would require any company contributions to such arrangements to be disclosed in the All Other Compensation column, and proposed Item 402(c)(2)(ix)(B) would require earnings on these amounts to be disclosed in the Summary Compensation Table, any additional disclosure would result in "double-counting" and would be of little value to investors.

(j) Perquisites – relocation programs. We disagree with the Commission's decision to exclude broad-based employee relocation programs from the definition of "plan" under Instruction 6 of proposed Item 402(a)(3). We are not aware of any abuse of these types of programs and, therefore, do not see any particular reason why they should be singled out for punitive treatment. We recommend that the Commission restore broad-based employee relocation programs to the definition of "plan" under Instruction 6 to proposed Item 402(a)(3).

(k) Timing of disclosure. We recommend that the Commission make clear in the final rules that compensation attributable to a covered fiscal year should be reported for that year, even if granted or awarded in the subsequent year. Currently, we note that some companies report awards made in the current year (for example, in fiscal 2006) in their fiscal 2007 proxy statement, even though the awards are attributable to services performed in fiscal 2005 (and, therefore, should be included the 2006 proxy statement). Because we believe that is significant inconsistency in the reporting approaches between companies, we request that the Commission clarify its preferred reporting.

IV. SUPPLEMENTAL TABLES AND NARRATIVE TO THE SCT

1. Stock awards. Proposed Items 402(d) and (e) would require the disclosure of both performance-based and service-based stock awards and stock options, as well as awards under non-stock incentive plans. To enable investors to better evaluate the decisions of the compensation committee, we would recommend that the full grant date fair values of the granted awards be added to the two proposed supplemental award tables – the Grants of Performance-Based Awards Table[31] and the Grants of All Other Equity Awards Table.[32]

2. Non-Executive Disclosure. Proposed Item 402(f)(2) would require disclosure of the total compensation for the last completed fiscal year and the job description for up to three employees who were not executive officers during the last completed fiscal year and whose total compensation for that year was greater than that of any of the NEOs.

We recommend that the Commission withdraw this Proposal. We see no policy rationale for such a requirement. Moreover, we believe that such disclosure is inconsistent with the purpose for the disclosure of executive compensation information, would be injurious to companies (causing friction internally and providing competitors with potentially significant sensitive and confidential business information), and would create an additional significant administrative burden.

Many companies do not have the human resource information systems necessary to track and quantify the total compensation of potentially large numbers of employees in order to identify those whose total compensation exceeds that of the lowest-paid NEO. Consequently, for many mid-size and smaller companies, at the outset this would be a manual process. In addition, for global companies, quantifying the compensation for employees in foreign jurisdictions could

[31] Proposed Item 402(d).

[32] Proposed Item 402(e).

raise numerous valuation issues. In the case of a known executive officer, investors have a reasonable expectation that the company will make the needed investment to determine NEO status and to comply with applicable disclosure requirements. When the requirement is extended to a large, relatively-undefined group of employees, an investor's expectations become problematic. Monitoring employee compensation, particularly as total compensation is defined under Proposals, becomes quite a complex and expensive undertaking.

Further, while the names of these employees would not need to be disclosed, their job descriptions alone may be sufficient to effectively identify them in many companies, resulting in an unwarranted invasion of their privacy. If the Commission's objective is to capture the total compensation of the heads of divisions or subsidiaries or others who may play a significant policy-making role in the company, we believe that the better approach would be to expand the definition of an NEO.

To the extent that this proposal is intended to ensure that influential or key employees who are responsible for managing significant operations or businesses but who are not executive officers of the company are subject to disclosure, we recommend that the Commission modify proposed Item 402(a)(3) to expand the NEO group to include individuals who head a principal business unit, division, or function of the company whose total compensation exceeds that of any of the company's three most highly-compensated executive officers who are part of the NEO group.[33]

3. <u>Determining discount options/SARs.</u> Instruction 6 to Proposed Item 402(e) provides that, in determining if the exercise or base price of a stock option, SAR, and similar option-like instrument is less than the market price of the underlying security on the date of the grant, the company may use either the closing price per share of the security on an established public trading market on the date of the grant, or if no such market exists, any other formula prescribed for the security. We recommend that the Commission modify this instruction to permit, in the case of a security on an established public trading market, the use of other pricing methodologies in addition to the closing price per security on the date of the grant.

In our experience, companies use a wide range of methodologies to establish the exercise price of their stock options and SARs. While the closing price per security on the date of the grant is one such methodology, it is not the exclusive methodology employed. Some companies use the closing price per security on the date preceding the date of grant, while others use of the average of the high and how trading price per security on the date of grant. Instruction 6 to proposed Item

[33] We also note that Instruction 2 of proposed Item 402(a)(3) notes that it may be appropriate for a company to include as an NEO one or more of the executive officers of subsidiaries in the disclosure required by the item.

402(e) presents a situation where a stock option or SAR is priced using one of these alternate methodologies, it would be considered a discount stock right for disclosure purposes. This would not only be incorrect as a contractual matter, it also raises the possibility that the stock right could be considered a discount stock right for purposes of Internal Revenue Code Section 409A,[34] thereby potentially creating significant federal income tax issues for the affected NEO.

3. Definition of the term "plan." Instruction 6 to proposed Item 402(a)(3) provides that companies may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms, or operation, in favor of executive officers or directors and that are available generally to all salaried employee. In the case of companies with foreign employees, we have encountered situations where a company may not be able to offer certain benefits to such employees due to the laws of the employees' jurisdiction. As a result, these companies are not technically able to exclude information about their welfare plans from their disclosure because they are not generally available to all employees. Since the disclosure of information about these plans is not material to an investor's understanding of a company's executive compensation programs, we recommend that the Commission modify this instruction to exclude non-U.S. employees from its terms.

V. POST-EMPLOYMENT PAYMENTS AND BENEFITS

A. Retirement Plan Potential Annual Payments and Benefits Table

Although we support the Commission's effort to provide more detailed and specific information about the retirement benefits potentially payable to the NEOs, we believe that the tabular disclosure that would be required by proposed Item 402(i) is unnecessarily complex.

While the tabular presentation envisioned in the Retirement Plan Potential Annual Payments and Benefits Table will provide detailed information about the value of each NEO's estimated retirement benefits under each defined benefit pension plan maintained by the company, it will not necessarily result in greater clarity about this compensation element. For example, because of the differences in plan design and operation, as well as differences in payment forms, investors will not be able to simply add together the amounts shown for each different plan to produce a total retirement benefits figure. In addition, the potential amount of information that would have to be provided in this table could be overwhelming. In our experience, most companies have multiple defined benefit pension plans for their executives – a tax-qualified defined benefit pension plan, an "excess" retirement plan, and, possibly, a supplemental

[34] 26 U.S.C. §409A.

executive retirement plan. To complicate matters, many of these plans have been bifurcated in the past year to "grandfather" pre-January 1, 2005 benefits for purpose of Section 409A. Thus, it is possible that some companies would have to disclose four or five different plans for each NEO. Variations in plan provisions with respect to payment form, early retirement subsidies, credited service, and so forth would further complicate the presentation. Finally, given the latitude that companies would have under the Proposals to select assumptions for the calculations, investors may need expert assistance to compare different plans.

We believe that these problems can be avoided by modifying the Retirement Plan Potential Annual Payments and Benefits Table in several respects. As modified, the table would be divided into two principal categories:

1. Current Benefits. This category would show the accrued defined benefit pension plan benefit at fiscal year-end and annual increases in the actuarial value of the defined benefit pension plan benefit.

2. Projected Potential Benefits. This category would show the projected normal retirement age benefit and the projected early retirement age benefit.

In the case of the current benefits, the following information would be disclosed:

- The assumed retirement age at which the fiscal year-end accrued benefit is payable (would match the assumptions used in the Summary Compensation Table);
- The credited years of service as of the last day of the last completed fiscal year;
- The life income equivalent benefit; and
- The current age present value of this benefit, regardless of whether a lump sum payment is available immediately or in the future.

In the case of the annual increase in the actuarial value of the defined benefit pension plan benefit, this increase in value would be shown for each of the three fiscal years covered by the Summary Compensation Table.

In the case of the projected potential benefits, the following information would be disclosed:

- The assumed normal and early retirement ages;

  - Normal retirement age should be the earliest age at which an executive officer is eligible for an unreduced benefit assuming continued employment to such age, unless a contractually-specified age exists.
  - Early retirement age should be the earliest age at which an executive officer's benefit could commence (likely with a reduction) assuming continued employment to such age.
- The projected years of service at each assumed retirement age;
- The life income equivalent benefit; and
- The lump sum value of this benefit or the present value of the benefit if a lump sum payment is not available.

To ensure consistency in the calculations of the disclosable amounts, we would recommend that this tabular disclosure be subject to the following parameters:

- All assumptions used for making the calculations would be consistent with those used by the company in preparing its financial statements to the extent appropriate;
- Future compensation would be based on an NEO's current base salary plus target short-term and long-term incentive payouts that are eligible for inclusion in the benefits formula;
- The compensation limits for tax-qualified defined benefits should not be indexed in order to be consistent and show the proper mix between the tax-qualified plan and nonqualified plan benefits;
- The lump sum value of the disclosed benefits would reflect the estimated lump sum value if such a payment form is available under the plan or, if no such payment option exists, the present value of the benefits; and
- The form of benefit actually elected by the NEO would be disclosed in a footnote to the table, but the amount payable under the payment form would not need to be quantified.

We have attached an example of such a modified table to this letter for the Commission's consideration. We believe that this table would not only simplify compliance and promote investor understanding, it would also eliminate any need to include the increase in the actuarial value of defined benefit pension plans in the Summary Compensation Table. In our view, the primary advantages of this modified table are as follows:

(a) Both the life income and lump sum benefit values (or present value if a lump sum payment is not available) would be disclosed, regardless of the form of benefit currently elected by the NEO. This would allow investors to compare the value of the estimated benefits consistently.

Even if a company does not provide a lump sum payment option, the disclosure ensures that a total value figure is provided. This would enable investors to better understand what the annuity amount is worth.

(b) The years of service at the assumed retirement age (both normal and early) would be disclosed. This would enable investors to ascertain the period over which the estimated benefits will be earned.

(c) In addition to disclosing the accrued benefit at fiscal-year end, the incremental increase in the accrued benefits for the past three fiscal years would be disclosed in the table. This would enable investors to place the growth rate of the benefits within the context of the total period in which it is earned. We believe that including this information as part of this table would provide a context for investors to access the change from year to year.

B. Nonqualified Defined Contribution and Other Deferred Compensation Plans Table

While, as previously noted, we support the Commission's effort to provide more detailed and specific information about the retirement benefits potentially payable to the NEOs, we recommend that the Commission modify proposed Item 402(j) to alter this mix of information that would be provided in the table. As modified, the table would be divided into two principal categories – NEO contributions and company contributions. Within each broad category, the following information would be disclosed:

- Contributions during the last completed fiscal year;
- Aggregate earnings during the last completed fiscal year;
- Aggregate withdrawals and distributions during the last completed fiscal year; and
- The aggregate account balance as of the last day of the last completed fiscal year.

The disclosure of investment earnings would be supplemented by separate disclosure of the amounts representing "above-market" earnings. In addition, we would recommend that the disclosure of investment earnings be supplemented to separately disclose any earnings associated solely with an increase in the value of the company's stock. This type of investment aligns an NEO's benefits with company performance and is cost-neutral to the company. Finally, we would recommend that the method for determining investment earnings be described in the supplemental narrative discussion about the table.

We have attached an example of such a modified table to this letter for the Commission's consideration. In our view, this table would not only simplify compliance and promote investor understanding, we believe that it would also eliminate any need to include investment earnings in the Summary Compensation Table and would better enable investors to assess the value created through company contributions to these arrangements compared to elective deferrals.

C. Severance and Change-in-Control Payments

We agree with the Commission's objective of improving the quality of disclosure about executive severance and change-in-control provisions. We believe that, given the increased attention and scrutiny that these arrangements have received, investors would benefit from additional and more specific information about the severance and other payments and benefits that NEOs may receive upon termination of employment or following a change-in-control of the company.

However, we believe that, to achieve this objective and to avoid an undue compliance burden on companies, the Commission should make the following revisions to proposed Item 402(k).

1. Events triggering disclosure. Proposed Item 402(k) would require disclosure of the potential payments to a named executive officer at, following, or in connection with any termination, including without limitation, resignation, severance, retirement or a constructive termination, or a change in control of the company or a change in the named executive officer's responsibilities. It appears to us that the descriptions of the precise events that trigger disclosure need to be clarified. For example, we assume that "severance" is intended to mean both a termination of employment with cause as well as a termination without cause. Similarly, we assume that a termination resulting from a change in a named executive officer's responsibilities must be preceded by a change-in-control of the company in order to be a triggering event. Consequently, we recommend that the Commission modify proposed Item 402(k) to clarify that the events that trigger disclosure of potential payments to a named executive officer would include, without limitation:

- resignation;
- retirement;
- termination of employment (with or without cause);
- a constructive termination of employment (termination for good reason);
- termination of employment following a change-in-control of the company; and

- termination of employment resulting from a change in the named executive officer's responsibilities following a change-in-control of the company.

2. Require tabular disclosure. In order to enhance investors' ability to access and understand the information that would be required by proposed Item 402(k), we recommend that the Commission require that the required disclosure be presented in a tabular format. We believe that using a table would be more beneficial than a narrative presentation of the required information as it would be easier to read and more readily facilitate comparisons between executives and companies.

While there are any number of ways that this table could be structured, we believe that the table should be divided into three principal categories – voluntary termination of employment (covering resignation, retirement, and a constructive termination of employment (termination for good reason)), involuntary termination of employment (covering termination of employment with and without cause), and termination of employment following a change-in-control of the company (covering termination of employment following a change-in-control of the company and a termination of employment resulting from a change in the named executive officer's responsibilities following a change-in-control of the company). Within each broad category, the following information would be disclosed:

- Cash payments (including severance payments and any other amounts);
- Defined benefit pension plan enhancements (if any);
- Accelerated vesting of nonqualified deferred compensation and supplemental defined benefit pension benefits;
- Accelerated vesting of stock awards, stock options, and SARs;
- Payouts of performance shares or other performance-based awards;
- Payouts of non-stock incentive plans awards;
- Continuation of perquisites and other personal benefits;
- Excise tax or other tax gross-up payments and reimbursements; and
- The total of all of these amounts.

3. Limit Quantification of change-in-control payments to CEO. We are concerned about the volume of information that would be required under proposed Item 402(k). Where a company has severance and change-in-control arrangements in place with its senior executives that provide for different payout formulas depending on the nature of the termination of employment, companies may need to provide multiple disclosure scenarios (accompanied by explanatory narrative disclosure) for each NEO. Consequently, the potential amount of information that

would have to be provided could be overwhelming. We recommend that the Commission modify proposed Item 402(k)(2) to limit the requirement to quantify the estimated annual payments and benefits that would be provided in each covered circumstance to the company's principal executive officer. This would reduce the compliance burden to companies significantly, while still providing investors with the level of detail that they seek about potential severance and change-in-control payments and benefits for the company's most senior executive.

4. Assumptions for termination scenarios. To ensure that the disclosure of the estimated payments and benefits that would be provided to named executive officers in connection with a termination of employment or change-in-control of the company would be useful to investors, further guidance is needed with respect to how to calculate such payments and benefits. In many instances, the amount of these payments and benefits will be dependent on future events and circumstances that may be unknown (and likely unknowable) by a company at the time that it is preparing the disclosure. Thus, without guidance as to the assumptions that should be used to calculate these amounts, companies will encounter significant challenges in developing assumptions, which will impose an undue administrative burden and expense on compliance. In addition, guidance is necessary to ensure comparability of the information between companies, which otherwise may use widely different assumptions to calculate the disclosable amounts for their NEOs. This is likely to be detrimental for investors, who may need expert assistance to compare different arrangements among different companies.

Therefore, we recommend that the Commission provide a specific Instruction with respect to proposed Item 402(k)(2) that would include the following guidelines for a company to use in quantifying the disclosable amounts and payments:

- A company should assume that the NEO terminated employment as of the last day of the last completed fiscal year;
- The market price of the company's stock on the last day of the last completed fiscal year (or, if the last day is not a day on which the company's stock was traded, the last trading day of the last completed fiscal year) should be used to determine the value of any stock or stock-based award;
- Payments under incentive compensation plans and arrangements should be based on an award's target amount, unless the terms of the plan or arrangement, or the NEO's employment or other agreement, provides for a different payout amount;
- Perquisites and other personal benefits should be based on the aggregate incremental cost to the company for the contractually-specified term or, if there is no such term, using reasonable actuarial assumptions; and

- The cost of welfare benefits should be based on the cost to the company using reasonable actuarial assumptions.

5. Quantification of tax payments in connection with a change-in-control. Although not expressly identified in proposed Item 402(k), it is clear that one of the estimated payments that would have to be disclosed would be any tax gross-up payment or reimbursement payable in connection with a change-in-control of the company to offset any excise tax liability arising under Internal Revenue Code Section 4999. The calculation of this excise tax liability is often complex and subject to variety of factors, some of which are difficult to analyze at the time of the change-in-control, let alone assess years in advance of any such transaction. As a result, the disclosure of such information would be of little value to investors as any estimated tax gross-up payment or reimbursement is unlikely to bear a reasonable relationship to the actual liability (if any) that may arise in the event of an actual change-in-control. Consequently, we recommend that the Commission expressly provide in the Instruction to proposed Item 402(k) that, in the case of a change-in-control of the company, the required quantitative disclosure need not include an estimate of any tax gross-up payment or reimbursement that the company would be required to make to a named executive officer. Instead, we believe that it should be sufficient to identify the existence of such a payment arrangement and any material terms, conditions, and limitations related to such arrangement.

6. Information should be “furnished” not “filed.” In the Release, the Commission indicates that, in the event that uncertainties exist as to the provision of payments or benefits or the amounts involved, a company would be required to make reasonable estimates and disclose material assumptions underlying such estimates, and such disclosure would be considered forward-looking information as appropriate that falls within the safe-harbor for disclosure of such information.[35] Although the quantification of the payments and benefits payable upon termination of employment or a change-in-control of the company would necessarily involve estimates, frequently based on assumptions based on highly speculative forecasts of future events and conditions, we are concerned that investors would treat such estimates as reflective of the actual amounts that would be payable upon the occurrence of the related event. In other words, judged in the light of actual events, there is a high likelihood that the reasonableness of these estimates could be called into question where the actual payout exceeded the previously disclosed amount, thereby exposing the company to a possible SEC enforcement action or shareholder litigation. Consequently, we believe that the information required by proposed Item 402(k)(2) should be considered “furnished” rather than “filed” with the Commission.

[35] Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934.

VI. DIRECTOR COMPENSATION

1. Cash compensation. Proposed Item 402(l)(1) would require disclosure of the compensation of a company's directors for the last completed fiscal year in a tabular format. As part of this tabular disclosure, proposed Item 402(l)(2)(iii) would require disclosure of the aggregate dollar amount of all fees earned or paid in cash for services as a director, including annual retainer fees, committee retainer fees, committee chair fees, and meeting fees in a single column. Further, proposed Item 402(l)(3)(i) suggests that, as part of the narrative description of the factors necessary to an understanding of the director compensation disclosed in the table, a company consider providing a description of the standard fee arrangements for directors.

Most standard compensation arrangements for directors provide significant differences between retainer fees, committee fees, chair fees, and meeting fees. Thus, the aggregate dollar amount of cash compensation may vary significantly between directors in a given year, depending on individual assignments and responsibilities. Because we believe that investors are interested in understanding the composition of a director's cash compensation. we recommend that the Commission modify propose Item 402(l)(3) to add itemization of fee arrangements as an example of a factor that should be considered when preparing a narrative description to accompany the Director Compensation Table.

2. Grants of equity awards. In our experience, many director compensation programs include an equity component. Because the proposed Director Compensation Table would require disclosure of the grant date fair value of these equity awards, we believe that it would be appropriate to require a table comparable to the Grants of All Other Equity Awards Table under proposed Item 402(e) to provide the material terms and conditions of these awards. Accordingly, we recommend that the Commission require that a supplemental Grants of Equity Awards Table be provided to disclose the number of shares, options, and other securities awarded to a company's non-employee directors during the last completed fiscal year in addition to the grant date fair value of such awards.

3. Outstanding equity awards. The proposed Instruction to Item 402(l)(2)(iv) and (v) requires the footnote disclosure of the outstanding equity awards at fiscal year end for each director. We request clarification of precisely what information must be disclosed with respect to these outstanding equity awards. The Instruction provides that the required disclosure would be as required if the Outstanding Equity Awards at Fiscal Year-End Table under proposed Item 402(g) were required for directors. We presume that this disclosure would include all of the information

that would be required for NEOs in columns (b) – (g) of this table. If this is the case, we further request clarification as to whether this disclosure must be provided in a tabular format.

4. Non-stock incentive awards. Proposed Item 402(l)(2)(vi) would require disclosure of the dollar value of all earnings for services performed during the fiscal year pursuant to awards under non-stock incentive plans. We do not believe that this column is necessary and recommend to the Commission that it be deleted. In our experience, it is uncommon for directors to receive performance-based compensation. While it is true that a company can simply delete the column from the required table if there is nothing to report in it, a better approach would be to simplify the table by deleting the requirement. In the rare event that a company provided such an award, the final rules could simply require that the material terms of such award be described in the supplemental narrative to the table.

5. Earnings on outstanding stock awards. Proposed Items 402(l)(2)(iv), (v), and (vi) would require disclosure of all earnings on outstanding stock awards, option awards, and non-stock incentive plan awards, respectively. While we agree that these amounts should be disclosed as they are clearly compensatory, we do not believe that these amounts should be included in the same columns as the related award type. Instead, we recommend that the Commission require that such information be included in All Other Compensation column of the Director Compensation Table. To the extent that any such amounts exceeded $10,000 in a covered fiscal year, we would expect the amount to be separately identified in a footnote to the column.

6. Modified awards. The Instruction to proposed Item 402(l) provides that if a company has adjusted or amended the exercise price of stock options or SARs previously awarded to a director, whether through amendment, cancellation, or replacement grants, or any other means, or otherwise has materially modified such awards, the company must include, as an award required to be reported in the Option Awards column, the total fair value of the options or SARs as repriced or modified, measured as of the repricing or modification date.

We believe that only the incremental increase in the fair value for purposes of SFAS 123(R), and not the full recalculated SFAS 123(R) value, should be included in the Director Compensation Table. Otherwise, the inclusion of the full amount will be distortive of the affected director's actual compensation for the covered fiscal year.

7. Narrative disclosure of compensation policies and objectives. Because we believe that investors are interested in understanding a company's policies and objectives with respect to its director compensation program, we recommend that the Commission modify propose Item

402(l)(3) to add this item, as well as the company's share ownership and retention policies, as examples of factors that should be considered when preparing a narrative description to accompany the Director Compensation Table. While not every company has an articulated philosophy of director pay and/or share ownership and retention policies, where such a philosophy and/or policies exist, this information should accompany the director compensation disclosure.

VII. OTHER PROPOSALS

1. Compensation-related information. With the revision of the disclosure requirements under Form 8-K, we have seen a pronounced increase in the disclosure of executive compensation-related information throughout the years. While much of this information is aggregated and summarized at the end of the fiscal year in a company's proxy statement, in our experience that is not always the case. Some of these current reports may contain information that is of interest to investors concerning the reported compensation matters that does not find its way into the proxy disclosure. To simplify access to this information, we recommend that the Commission require companies to provide a list of their executive-compensation–related Form 8-Ks or other filings since their last proxy statement as part of their executive compensation disclosure.

2. Compensation consulting relationship. Proposed Item 407(e)(3)(iii) would require companies to disclose the role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying the consultants, stating whether the consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement, and identifying any executive officer within the company the consultants contacted in carrying out their assignment.

We recommend that the Commission withdraw this Proposal. We are concerned that disclosing the identity of the compensation consultant would lead investors to draw erroneous conclusions about the consultant's role; quite possibly suggesting that the compensation decisions reflected in the CD&A and other executive compensation disclosure were recommended or supported by the consultant. The proposed requirement that compensation consultants be disclosed appears to reflect a misunderstanding of how companies use consultants. In today's environment, most compensation committees directly retain the services of a compensation consultant to provide advice on executive remuneration matters. However, the scope of these engagements varies greatly from company to company and even from year to year. A compensation consultant may not be retained by the committee to advise on every aspect of the company's executive compensation program, may be asked to provide data only, may or may not attend compensation committee meetings, and may or may not make recommendations on any given plan or arrangement. Even where recommendations are made, they may not be followed by the compensation committee. It is not uncommon, for example, for compensation committees to negotiate the compensation arrangements for a new hire or the severance package for a departing executive without ever seeking advice from a compensation consultant. In addition, compensation committees often do not ask consultants for their advice on long-standing employment agreements or other arrangements that pre-date the consultant's involvement with the committee.

We anticipate that, if the Proposals are adopted, in order to protect their reputations, compensation consultants would expect to either broaden their relationships to ensure involvement in disclosed programs or demand detailed disclosure of the compensation elements on which they were consulted.

If, however, the Commission decides that some level of disclosure is necessary, we recommend that the Commission make clear that it is the identity of the compensation consulting firm, and not the individual consultants, that must be disclosed. In addition, since compensation committees often seek counsel and advice from other professional advisors, we recommend that the Commission require that the identity of these other advisors also be disclosed. In particular, executive search firms and outside legal counsel often play a key role in developing and implementing recommendations regarding executive compensation packages.

We also recommend that the Commission withdraw the proposal that would require disclosure of the identities of the executive officers with whom the compensation consultant has had contact. Many typical consulting projects involve interviews with numerous senior management team members to discuss business strategy and performance, organization culture and philosophy, the scope of responsibilities of the executive (and his or her direct reports), and to solicit and check company financial and compensation data. Tracking each of these contacts would pose a significant burden that is not warranted by the value of the information to investors. For example, it is unclear whether the Proposals would require disclosure of a telephone inquiry to the head of the Human Resources Department or the chief financial officer to verify compensation data. Moreover, the disclosure of all such contacts without an explanation of the reason for the contact could be misinterpreted by investors as an indication that the contacted executive or executives had undue influence over the consultant's recommendations to the compensation committee. Where there is such a perceived risk, we expect that compensation committees will seek to limit the consultant's contact with the company's executive officers. Such a restriction could impair the ability of the compensation consultant to do a thorough job (for example, in areas such as incentive and equity plan design) and ultimately would lead to recommendations to the compensation committee based on potentially incomplete information.

We note that some observers have suggested that the Proposals be expanded to require that compensation consultant disclose their fees from the company. In some cases, the motivation for this request is to ensure that compensation consultants with multiple lines of business disclose all fees paid by the company regardless of whether they are related to services provided in connection with the company's executive compensation and benefit program.

We believe that the proper area of inquiry is whether the compensation consultant is able to fulfill the scope of its engagement to the satisfaction of the compensation committee and in furtherance of the best interests of the company's shareholders. These objectives are met where the consultant has rendered complete and accurate advice and/or information to the committee, within the parameters of the particular engagement. Thus, the pertinent disclosure should not dwell on fees,[36] but instead elicit confirmation that the compensation committee has sought and obtained full disclosure of the relationships between the compensation consultant and the company, discussed with the consultant its ability to provide impartial advice and/or information, and made an affirmative determination that any pre-existing relationships will not affect the services being provided by the consultant. Given the nature of the compensation committee-compensation consultant relationship, it is the responsibility of the committee to ensure that it has retained appropriate advisors to assist it in carrying out its duties and, ultimately, to accept or reject the consultant's recommendations. Investors are entitled to know that the committee is discharging these responsibilities.

VIII. TRANSITION AND EFFECTIVE DATE

1. <u>Transition.</u> Section VII of the Release provides that the changes to the Summary Compensation Table would be phased in over a three-year period for Regulation S-K companies and over a two-year period for Regulation S-B companies. We request that the Commission confirm our understanding of how this phase-in would work. It is our understanding that, for a company with a calendar year fiscal year, (a) in the case of the fiscal year ending December 31,

[36] In our view, fee disclosure is relevant only in the context of total firm revenue. In this way, investors would be able to see clearly the portion of a consultant's revenue derived from a company that is related to executive compensation consulting and, further, whether the consultant is at financial risk if it were to lose the company as a client.

2006, the Summary Compensation Table need include only compensation information with respect to fiscal 2006, (b) in the case of the fiscal year ending December 31, 2007, the Table need include only compensation information with respect to fiscal 2006 and 2007, and (c) in the case of the fiscal year ending December 31, 2008, the Table need include compensation information with respect to fiscal 2006, 2007, and 2008.[37]

Because it is possible to read the transition guidance as requiring a full Summary Compensation Table covering the last three completed fiscal years, with the information for fiscal years prior to 2006 being presented under the current rules, rather than the proposed new rules and amendments, we recommend that the Commission resolve this potential ambiguity.

2. Effective Date. Section VII of the Release provides that, in the case of proxy statements, the proposed new rules and amendments would become effective for such documents that are filed 90 days or more after publication of the adopting release in the Federal Register. Depending on when final rules are adopted, reporting companies with fiscal years in the fall of 2006 (for example, September 30) could become subject to the disclosure framework at a time when their proxy statements are substantially completed. To avoid the compliance uncertainties that arise with an effective date tied to adoption and publication of final rules, we recommend that the Commission simply make the rules effective for proxy statements filed in connection with fiscal years ending on or after December 15, 2006.

* * * * *

[37] To minimize investor confusion during this transition period, we recommend that the Commission require companies to identify in a preface to the Summary Compensation Table the filing or filings in which investors can locate the prior year or years' executive compensation information.

We appreciate the opportunity to comment on the Proposals, and respectfully request that the Commission consider the recommendations set forth in this letter. We are prepared to meet and discuss these matters with the Commission and its staff at its convenience. Any questions about this letter may be directed to Diane Doubleday (415) 743-8748 or Mark A. Borges (202) 387-4607.

Respectfully submitted,

Diane Doubleday

A version of this article will be published in the Summer 2006 issue of the Journal of Pension Benefits

A Best-Practice Strategy for Disclosure

The SEC's sweeping executive compensation disclosure reforms will compel companies to adopt a higher standard for disclosing pension benefits and other forms of executive pay, whether adopted as proposed. Heightened disclosure will dictate that companies better understand and position these plans to effectively communicate their relative value to shareholders.

by Janet Den Uyl and Doug Frederick, FSA, EA, MAAA
Mercer Human Resource Consulting

The comprehensive changes in executive compensation disclosure proposed this year by the Securities and Exchange Commission (SEC) for implementation in 2007 proxy statements are reverberating throughout corporate America. Responding to shareholders' criticism of inadequate and confusing executive pay information, the SEC proposals would require companies to provide a total compensation figure for top executives, as well as a detailed discussion of how their executive compensation program is structured and executed.

The proposals also would require far more quantitative information about retirement benefits, deferred compensation, severance benefits, perquisites, and equity awards for top executives, along with other qualitative requirements. As a result, plan sponsors and their professional advisors need to assess how the proposals will impact their companies—because regardless of how they are revised, they will surely establish a new "best practices" standard. This article focuses on the proposals' effects on retirement benefit and deferred compensation plans – what needs to be disclosed, what are the key implications and anomalies, and what companies should proactively consider during 2006 in anticipation of preparing their 2007 proxy statements.

What Needs to Be Disclosed?	What Are Key Implications and Anomalies?	What Should Companies Do in 2006?
▪ Compensation discussion and analysis ▪ Value of benefits included in Summary Compensation Table ▪ Retirement Plan Potential Annual Payments and Benefits Table ▪ Nonqualified Defined Contribution and Other Deferred Compensation Plans Table	▪ Who will be a Named Executive Officer? ▪ Accrual patterns in defined benefit retirement plans ▪ Multiple defined benefit retirement plans ▪ Volatility and magnitude of deferred compensation investment earnings	▪ Determine what values will need to be disclosed ▪ Compare plan provisions and relative value among peer group ▪ Assess whether to redesign plans ▪ Develop explanation for how plans meet compensation objectives and reason for unusual reported values

What needs to be disclosed?

Compensation Discussion and Analysis

The proposals introduce a new section, entitled the Compensation Discussion and Analysis (CD&A), that replaces the board compensation committee report and the performance graph. The CD&A would be a company, rather than a board compensation committee, disclosure, which would shift responsibility for the preparation and the contents of the discussion to corporate management. The CD&A is to set the context for the other required tabular and narrative disclosure by addressing the objectives and policies of the company's executive compensation program and how the program is implemented. The CD&A should take a "principles-based" approach to the required disclosure and avoid slipping into a "boilerplate" recitation of generalities. Companies will be required to provide details on each element of compensation (including retirement and deferred compensation plans) and state the element's objectives – what it is designed to reward, why the company chose it, how the amounts are determined, and how it fits into overall compensation objectives. To the extent that a company uses multiple plans to comprise a particular element, there will need to be commentary provided on how each plan fits into the total compensation program.

More specific detail about retirement benefits and nonqualified deferred compensation plans also will be required in the *Summary Compensation Table (SCT),* as well as the new *Retirement Plan Potential Annual Payments and Benefits Table* and *Nonqualified Defined Contribution and Other Deferred Compensation Plans Table*, respectively, as explained below.

Summary Compensation Table

There are two types of retirement plans – defined benefit and defined contribution plans. Currently, only company contributions to defined contribution plans are disclosed in the SCT. The proposals would expand the required disclosure to include the aggregate annual increase in the actuarial value of defined benefit retirement plans as accrued (but not necessarily vested) for each Named Executive Officer (NEO) – the CEO, CFO, and the three most-highly compensated executive officers other than the CEO and CFO. This defined benefit value must include the increase in value of all retirement benefits including qualified pension plans, supplemental executive retirement plans (SERPs), and benefits under employment contracts.

The increase in the aggregate actuarial value represents the difference between the present value of accrued pension benefits at the beginning and the end of the fiscal year, using actual pay, current service, and appropriate actuarial factors. Once a benefit is fully accrued, there would continue to be an amount included in the SCT due to the investment earnings cost (i.e., the increase in present value of the benefit due to the fact that the benefit is payable one year sooner). While the actuarial factors are not prescribed, they would need to be disclosed in a footnote to the table.

The proposals also would require the disclosure of investment earnings attributed to both a participant's elective nonqualified deferred compensation and company contributions to all defined contribution plans (qualified or nonqualified). Currently, only investment earnings deemed to be "above-market" attributed to elective deferrals is disclosable. However, investment earnings attributed to qualified defined contribution plans is not required to be disclosed in contrast to the requirement for defined benefit retirement plans which includes values for both qualified and nonqualified plans.

Retirement Plan Potential Annual Payments and Benefits Table

This table would replace the current Pension Plan Table found in proxy statements and would require disclosure of the estimated benefits payable under each defined benefit retirement plan in which an NEO participates. The table includes projected benefits payable at normal retirement age and, if applicable, early retirement age for each plan using projected service and current pay. In addition to tabular disclosure, a supplemental narrative is required. It must include the material factors necessary to understand the operation of each plan, such as the benefit formula, definition of compensation included in it, plan eligibility standards, and the company's policy (if any) for granting extra years of credited service to participants. In addition, where the credited years of service under a plan for any NEO differ from his or her actual years of service, this fact would have to be footnoted, along with the amount of the benefit increase.

The instructions to the table stipulate that the estimated benefit payments should reflect the form of benefit that the NEO has currently elected. If a plan permits a lump sum distribution, the current value of the lump sum would have to be quantified in a footnote.

Nonqualified Defined Contribution and Other Deferred Compensation Plans Table

The proposals add a new table that would include specified information about each nonqualified defined contribution and deferred compensation arrangement in which the NEOs participate. Since over 80% of *The Wall Street Journal* 350 companies have nonqualified deferred compensation plans and most companies have multiple plans, there will be much information to disclose. For each plan, the table must include the NEO contributions, company contributions, aggregate earnings accrued during the year (including on NEO contributions), aggregate withdrawals and distributions, and aggregate year-end account balances.

What are key implications and anomalies?

Named Executive Officers

Companies will need to calculate benefits for all executive officers each year to determine their NEOs. Other than the two required NEOs (the CEO and CFO), there could be significant fluctuation in the remaining three NEOs, because NEO status will be based on *total* compensation (including retirement benefits and deferred compensation) instead of *cash* compensation.

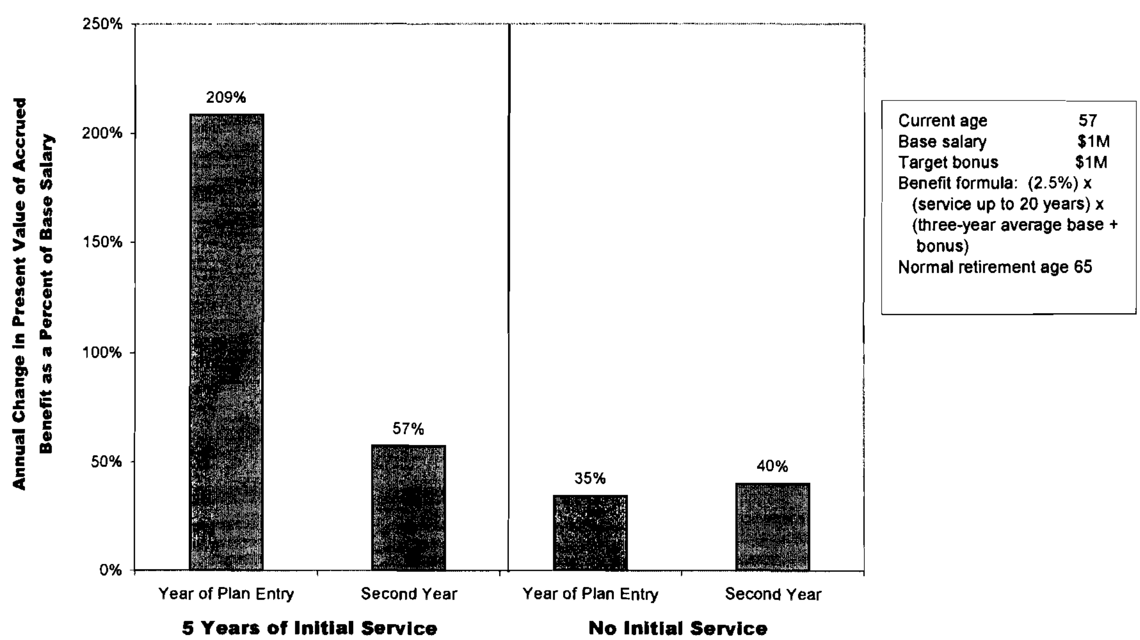
Accrual Patterns in Defined Benefit Retirement Plans

Defined benefit retirement plans with the same target normal retirement age benefit may accrue at different rates. The difference in the accrual pattern will not be ascertainable from the number disclosed in the SCT, potentially leading to inappropriate conclusions about the relative pay of NEOs.

The incremental aggregate present value is affected by many factors – the rate of accrual, compensation increases, service (including past service or notional service credit), assumed investment earnings rate, and life expectancy assumptions. It is possible for a new entrant with either significant past service or notional service to have a first year accrual that would place him or her into the NEO group, yet exclude him or her from the group in subsequent years as illustrated in Chart 1.

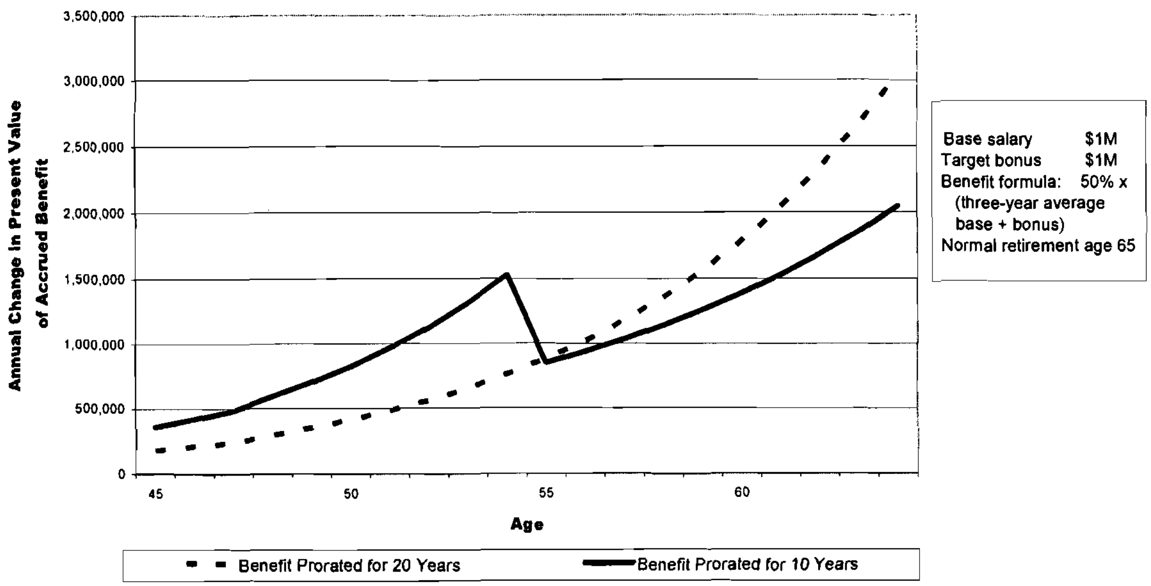
Chart 1

Value of Defined Benefit Retirement in First Years of Eligibility



While the target benefit at normal retirement age may be the same between two plans, it is not uncommon to have widely different rates of accruals. Counter-intuitively, a plan that accrues the benefit more rapidly (e.g., over 10 years service) could lead to a lower amount disclosed in the SCT once the service threshold is attained than a plan with a slower rate of accrual (e.g., over 20 years service). The example in Chart 2 illustrates this discrepancy. Again, incorrect conclusions could be drawn during the last 10 years unless the underlying benefit formula is understood.

Chart 2
Annual Value of Defined Benefit Retirement is Greatly Affected by Accrual Rate



Unexpected changes in compensation (e.g., from a large bonus payout) in the final years before retirement could also cause a spike in the incremental value that would need to be disclosed. A large bonus payment in the final average pay period would affect the annual accrual, because it would be attributed to all prior years of service. Also, early retirement can result in a larger amount paid to a NEO than accrued, due to favorable subsidies that are not reflected in the annual accruals.

Multiple Defined Benefit Retirement Plans

While the tabular format in the Retirement Plan Table will provide explicit disclosure of the value of retirement benefits under each plan, it will not necessarily add more clarity. Investors will not be able to simply add the values due to the varying payment forms. The amount of information required by this table could be overwhelming, due to the provisions with respect to normal retirement age payment form, early retirement subsidies, credited service, etc. and the large number of plans – many acquired through corporate mergers and some that were bifurcated to comply with Section 409A. In addition, given the latitude that companies will have to select assumptions for the calculations, investors may need expert assistance to compare different plans.

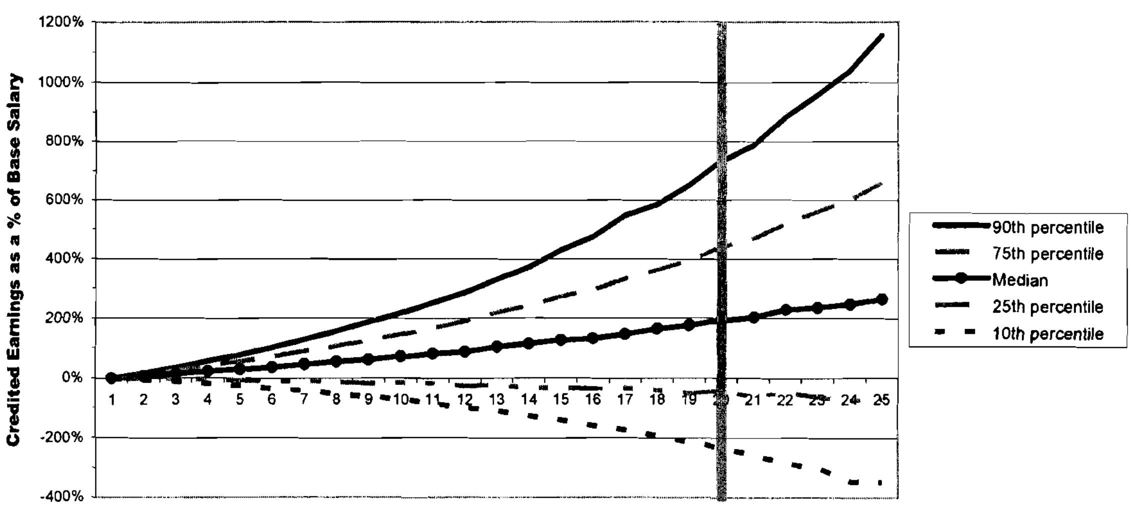
Volatility and Magnitude of Deferred Compensation Investment Earnings

With the inclusion of investment earnings on all deferred compensation in the SCT, this item alone could affect who is considered to be an NEO and it could overshadow other forms of compensation due to fluctuations in the rate of investment earnings credited.

Of *The Wall Street Journal* 350 companies that have deferred compensation plans, 80% allow participants to select among investment earnings options for the deemed return credited to the deferred compensation balance or have the return tied to the performance of company stock. As the example in Chart 3 illustrates, it is quite possible for the investment earnings for a specific NEO, who is a long-term saver, to be a large multiple of base salary in any given year (see shaded line at year 20). It also illustrates that poor market returns could cause an NEO to have a much smaller amount of total compensation reported than he or she actually received due to investment earnings losses, which are not even realized.

Chart 3

Volatility of Deferred Compensation Earnings



- Participant has 100% target bonus and defers half of it each year.
- IMPORTANT: The projections or other information regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results.
- Returns simulated based on historical S&P 500 returns (1928-2004).
- 10,000 random outcomes are used; it is possible for results to vary when a similar analysis is repeated.
- Other investments may have similar or superior characteristics.

The inclusion of investment earnings (instead of just the portion considered "above-market") attributed to elective deferrals is problematic because it overstates the wealth of executives who postponed receipt of compensation compared to those who did not defer compensation and might have made identical investments outside the plan.

What should companies do in 2006?

As a first step, companies should calculate the potential proxy disclosure associated with their retirement and deferred compensation plans for all potential NEOs. No doubt, there will be many anomalies that will cause Boards to want to drill down to have a much better understanding of how these plans work.

Most companies will want to conduct a peer-group analysis of their executive benefit plans. It will help them position the relative value in the CD&A. By providing shareholders with a better understanding of how their benefit plans compare to those of their peers, companies will achieve more than transparency in their disclosures—indeed, their disclosures will make greater sense.

Fortunately, tools and processes exist for this type of analysis, which requires a projection of corporate plans under comparable financial assumptions to a peer group of companies. For example, Mercer Human Resource Consulting's proprietary Executive Benefits Research Tool (EBeRT), which contains publicly-disclosed information on executive retirement and deferred compensation plans for more than 500 large publicly held companies, is used to compare the prevalence of plans, the key provisions, and the relative value of profile executives among peer group company plans.[1]

Once a complete analysis is conducted, some companies may want to either redesign or terminate some of their plans. Unfortunately, it may not be viable to terminate plans due to restrictions under Section 409A or to the loss of deductibility under IRC Section 162(m). For this reason, companies may want to take advantage of the remaining window in 2006 under Section 409A for making changes to their plans involving the timing and payment options available to participants.

Conclusion

Although the proposals, if adopted, will not be effective until the 2007 proxy season, companies will want to get a head start on understanding the implications of and the transition to the proposed new disclosure system. Given the magnitude of the potential effects of defined benefit retirement plans and investment earnings on deferred compensation plans, they will want to assess the values reported under these plans, understand how they compare to their peer group, and potentially consider redesigning these plans to the extent it makes sense.

Most importantly, companies should recognize that their current compensation and benefit decisions would be subject to new – and more extensive – disclosure requirements next year. As a practical matter, this means that they will be expected to explain the rationale for these decisions in the context of their overall executive compensation program, as well as demonstrate how the amounts paid to each NEO are consistent with their compensation philosophy and the program's objectives. For companies that have not previously approached their disclosure in this

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[1] *Mercer Human Resources Consulting does not provide legal or tax advice.*

manner, it may be a daunting task. Thus, companies should begin familiarizing themselves now with how their programs will look under the new disclosure system, identify and address any inconsistencies, deficiencies, or omissions, and satisfy themselves that they can present a compelling story about their executive pay program.

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Nonqualified Defined Contribution and Other Deferred Compensation Plans

Name and Principal Position	**Plan Name**	**Executive Contributions**				**Registrant Contributions**			
		Contribution Last FY	Aggregate Earnings in Last FY	Aggregate Withdrawals/ Distributions	Aggregate Balance at Last FY	Contribution Last FY	Aggregate Earnings in Last FY	Aggregate Withdrawals/ Distributions	Aggregate Balance at Last FY
CEO	#1								
	#2								
CFO	#1								
	#2								

Comments:
* Provide a breakout of any earnings that are above-market.
* Provide a breakout of any earnings associated solely with company stock.
* Describe method for determining investment earnings.

Retirement Plan Potential Annual Payments and Benefits Table

Current Accrued Benefits and Actuarial Value for Past Three Fiscal Years									
			Accrued Benefit at Fiscal Year-End				**Actuarial Value of Benefit Increase**		
Name and Principal Position	**Plan Name**	**Current Age**	Assumed Retirement Age	Current Service	Life Income Value at Retirement	Current Age Present Value	Fiscal Year-End 2007	Fiscal Year-End 2006	Fiscal Year-End 2005
CEO	#1								
	#2								
CFO	#1								
	#2								

Projected Potential Payments at Normal and Early Retirement									
		Projected Normal Retirement Benefit				**Projected Early Retirement Benefit**			
Name and Principal Position	**Plan Name**	Assumed Retirement Age	Projected Service	Life Income Value at Retirement	Lump Sum Value at Retirement	Assumed Retirement Age	Projected Service	Life Income Value at Retirement	Lump Sum Value at Retirement
CEO	#1								
	#2								
CFO	#1								
	#2								

Comments:
* Where appropriate assumptions should be consistent with those used in preparing financial statements.
* Future compensation should be based on current base salary plus target incentive payouts that are pensionable.
* Normal retirement age should be the earliest unreduced age assuming continued employment until such age.
  alternatively, if a contractual retirement date has been established, then such age should be used.
* Early retirement age should be the earliest commencement age assuming continued employment until such age.
* Lump sum of benefits reflects the lump sum value if available or the present value of benefits if no lump sum option exists.
  Actuarial assumptions used to determine these values should be consistent with those used in preparing financial statements.
* Actual elected form of payments should be footnoted; however, the amount does not need to be calculated.