



INSTITUTIONAL SHAREHOLDER SERVICES

March 28, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington DC 20549-9303

Re: File Number S7-03-06

Dear Ms. Morris:

Thank you for the opportunity to provide feedback on the proposed amendments to the SEC's disclosure rules for executive and director compensation. The comments and suggestions in this letter reflect the views of ISS and do not necessarily reflect the views of our clients.

ISS Supports the SEC's Efforts to Improve Compensation Disclosure

ISS supports improvements in executive compensation disclosure. Current requirements, which have been static during the past decade, are out of step with the growing complexities in executive pay packages. Shareholders' frustrations with the lack of disclosure on retirement plans, change-in-control arrangements, and many forms of stealth compensation have led to a growing compensation lexicon, such as "tally sheets" and "holy cow" meetings. The proliferation of multiple pay vehicles and the increase in shareholder concerns over compensation arrangements necessitate change to the current disclosure system. Overall, the SEC's proposed rules are a positive step to mandate improved disclosure, create clarity for shareholders, and underscore the accountability of directors to ensure that shareholders' assets are used wisely.

The spirit of the proposed rules is consistent with the philosophy embodied in ISS' proxy voting policies – to enhance shareholder value, promote shareholder rights, and ensure director accountability. We commend the SEC staff for their efforts to ensure that shareholders obtain a clearer picture of executive compensation. Specifically, ISS supports the following proposed revisions to the SEC's disclosure rules:

- inclusion of a Compensation Discussion and Analysis (CD&A) section patterned after the Management's Discussion & Analysis (MD&A) disclosure;
- revision to the Summary Compensation Table to provide Total Compensation figures;
- inclusion of supplemental equity tables that disclose prior year awards as well as potential sources of future gains;
- disclosure of retirement and post-employment benefits; and
- tabular disclosure of director compensation.

ISS Recommends Several Enhancements to the Proposed Rules

While we generally support the Commission's proposed rules on executive compensation, we respectfully suggest that the SEC consider the following modifications:

Require the CD&A report over signatures of the compensation committee

Requiring the Compensation Discussion and Analysis to be "filed" and hence covered by the certification requirements of the Sarbanes-Oxley Act, is an excellent way to send a strong message of accountability to those approving compensation packages. The concept regarding the report being "furnished" rather than "filed" to allow for more robust discussion has not borne out. Rather than being robust, too much of the current disclosure is boilerplate, and the SEC has made clear in its current proposal that boilerplate disclosure is unacceptable. To increase accountability, we believe that the CD&A report should also be over the names and signatures of the compensation committee. Because the CD&A is intended as a principles-based document, the compensation committee would be signing off on the principles and practices that they utilize in creating pay packages. Their signatures reinforce the compensation committee's obligation and accountability to shareholders.

Require all companies, including small firms, to include the CD&A

The Commission indicates that the CD&A should focus on material principles underlying executive compensation policies and decisions. As such, the CD&A is key to ensuring that investors have a firm understanding of compensation decisions. Small companies should not be exempt from disclosing material information about compensation objectives and policies. Compensation arrangements in small businesses can be even more complex as a result of their limited cash flow situations, and we recommend that small businesses file CD&A disclosures.

Disclose performance targets or actual performance upon payouts

Companies should publicly disclose target levels for specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors. Without disclosing the specifics of performance targets, shareholders cannot assess the rigor of the program or the difficulty of meeting those targets. Performance targets could be disclosed either at the beginning of the performance cycle or after the completion of the performance period. The disclosure of performance targets does not create adverse competitive effect, as evidenced by the growing number of companies that have voluntarily disclosed specific hurdles that the named executive officers must clear to profit from performance-based equity awards.

Remove the \$10,000 minimum threshold for perquisites

We concur with the Commission's comments that the current perquisite exclusion of the lesser of \$50,000 or 10 percent of the total of an executive's annual salary and bonus has resulted in

material omissions. However, having a \$10,000 minimum threshold would allow companies to continue to avoid disclosure of many executive perquisites. Often, the small monetary value of perquisites belies their significance. Inappropriate perquisites, even in small dollar amounts, may portend larger compensation problems. Therefore, we believe that having no minimum threshold would shed light on all types of perquisites provided to executives and would minimize any abuse in this area.

Remove the compensation disclosure of up to three non-officer employees

The disclosure of up to three employees who are not executive officers but earn more in total compensation than any of the named executive officers will provide little value to shareholders without the appropriate narrative disclosure and the supplemental figures to support the total compensation figure. Unlike the named executive officers, the three non-officer employees are generally not individuals who have the ultimate authority over the company's strategic imperatives or broad business activities. Furthermore, these three individuals may change each year depending on their total compensation figures. The lack of continuous and consistent disclosure further dilutes the need for such information.

Require disclosure of all related-person transactions

The Commission's proposal to increase the minimum threshold for reporting related-person transactions from \$60,000 to \$120,000 will exclude many smaller transactions that in aggregate may be material enough to warrant shareholder concern. Therefore, we urge the SEC to require disclosure of all related-person transactions and not set a minimum threshold. This approach would allow shareholders to view and evaluate all related-person transactions and make their own determinations about the materiality of specific transactions or in aggregate. Also, any related-person transaction could potentially be problematic, and therefore it is important for shareholders to know of such potential conflicts. To make it easy for investors to review this data, the transactions should be listed in tabular form and in descending order from highest to lowest.

Mandate certain standard assumptions on FAS 123R for executive pay

ISS supports FAS 123R as the appropriate approach for valuing equity-based awards. Stock-based and option-based awards should be valued in total on the grant date and should not be adjusted on the vesting date. We agree with the SEC's proposed method that subscribes to the measurement method of FAS 123R, but also provides for immediate disclosure of compensation, separate from the compensation expense for accounting purposes. To make the total compensation figure comparable across companies, the SEC should mandate some standard assumptions for stock-based compensation. Specifically, we advocate for the full term assumption rather than expected term assumption for calculations for named executive officers. Expected term assumption can vary widely from company to company due to such factors as age, tenure, and income bracket. The full term assumption is objective and consistent, and will ensure that investors have apples-to-apples comparisons across companies.

Require full disclosure on deferred compensation plans

Quantification and disclosure of the costs of deferred compensation, including forgone tax deductions and the costs of investments, present a full and complete picture to shareholders. Therefore, ISS recommends disclosure of cumulative contributions and earnings accrued on deferred compensation plans. We also recommend disclosing the cumulative dollar amount of contributions, the aggregate interest or other earnings accrued from inception of the executive's participation in the plan through the end of the company's last fiscal year, and the specific interest rate applied to cash-denominated deferral accounts for the last fiscal year's accruals.

Require quantitative and tabular disclosure on potential post-employment payments

To be consistent with the additional tabular disclosure in supplemental equity tables and post-retirement tables, ISS recommends tabular disclosure regarding payments upon termination or change in control. The tabular disclosure should include each potential termination event, severance upon termination, and severance upon change in control.

Require aggregate actuarial value of pensions

The estimated annual retirement payment does not present the magnitude and potential pension cost to shareholders. ISS recommends the quantification of the aggregate actuarial value of pension for all companies without regard to whether the plan permits a lump sum distribution. We believe that the present value of a pension paid for the life of an executive provides the complete picture of the potential cost implications.

Retain key information available to shareholders under current rules

The Commission indicates that the proposed disclosure rules will build on current requirements rather than replace them. As such, several useful disclosure items should remain to provide clarity and completeness to investors. Information that is helpful to shareholders and should remain as disclosed items include: the five-year performance graph, the ten-year option repricing table, and the percent of total options granted column in the Grants of All Other Equity Awards table.

Rule Changes Will Lead to a Positive Impact for Shareholders

The proposed rules on executive and director compensation will address the major deficiencies in the current disclosure system. ISS supports the Commission's work, and we suggest further enhancements to ensure that shareholders have complete quantitative and qualitative information to assess executive pay. The revisions to compensation disclosure will serve shareholders well, provided that they, in turn, do their part as advocates in this process. In conjunction with the SEC's proposal, we urge continued engagement and constructive dialogue between issuers and investors to promote better disclosure of executive compensation, as well as more consensus on other corporate governance matters. For questions or comments on the points raised in this letter, please contact Valerie Ho at 301-556-0560, or Martha Carter at 301-556-0468.

Sincerely,

Martha Carter
RK

Martha L. Carter, Ph.D.
Senior Vice President and Managing Director, Corporate Governance
Institutional Shareholder Services