Center On Executive Compensation

July 17, 2009

VIA Electronic Submission

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: File No. 265-25, Investor Advisory Committee

Dear Ms. Murphy:

The Center On Executive Compensation is pleased to submit the attached proposal regarding clearer disclosure of executive compensation for consideration by the U.S. Securities and Exchange Commission's Investor Advisory Committee at its July 27, 3009 meeting.

The Center believes that current proxy statement disclosures obscure the link between pay and performance because they mix current actual pay with potential future pay (e.g., in the form of stock, options and long-term incentives). The Center's proposal separates pay received in the current year and compares it to the performance that generated it. It also provides a disclosure for future potential pay, based on a fair value estimate as of the grant date, and compares the estimate to the performance required to generate the pay. A full explanation of the problem and the Center's proposal are attached.

We would be happy to answer any questions that the Advisory Committee may have involving our analysis of the problem or our proposed solution.

Thank you for your consideration.

Sincerely,

Timothy J. Bartl
Senior Vice President and General Counsel

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Pay for Performance at a Glance: A New Model for Explaining Executive Compensation in Proxy Statements

Framework for Disclosure Provides a Way for Companies to Clearly Link Pay and Performance and Distinguish Current From Future Pay

Companies, shareholders, investors and activists all generally agree that executive pay should be linked to performance and that this link should be clearly disclosed. Yet, the U.S. Securities and Exchange Commission's disclosure rules do not foster a clear understanding of this link. Currently, the Summary Compensation Table that all public companies must include in their proxies must provide a total compensation number that mixes *actual pay* earned in the current year with *potential future pay* that may be earned in a later year. In the table, companies must report actual salary and bonus compensation for the year, and they must also report an accounting expense based upon the estimated pro-rata share of the expense attributable to prior year and current year equity compensation awards. This mixing of apples and oranges makes the total compensation number reported in the Summary Compensation Table a misrepresentation of a named executive officer's current pay and leads to inaccurate comparisons of pay and performance. Changes in disclosure recently proposed by the SEC, while helpful, do not address several key problems.

The Center believes that improving the manner in which companies disclose the pay-for-performance linkage will allow companies to more clearly explain their executive compensation programs in the Compensation Discussion and Analysis (CD&A) section of the proxy. Improving disclosure will also give shareholders better information about company pay programs, enabling them to evaluate whether, among other things:

- pay is linked to performance;
- pay is appropriate in light of the company's competitive position; and
- the compensation committee is thoroughly evaluating compensation plans and incentivizing the sustained creation of shareholder value.

The Center believes that the best way to more clearly present and disclose executive compensation is to change the Summary Compensation Table to separate actual from potential pay or, short of that, to require the two short supplemental disclosures explained below.

The following analysis discusses the problems with the current Summary Compensation Table and recommends that the Commission require companies to add two short disclosures near the front of the CD&A. The first disclosure would address actual pay earned in the period reported and the corresponding actual performance that generated it. The other disclosure would address the potential future pay from long-term incentives and the level of performance required to achieve those payouts. The Center believes that integrating this disclosure into the CD&A would facilitate better communication and understanding of company pay practices to the benefit of

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shareholders, boards and regulators and has the strong potential to shorten increasingly long CD&As.

Current Shortcomings of the Summary Compensation Table

The Summary Compensation Table required by the SEC is intended to provide investors a snapshot of the total compensation for the named executive officers in the reporting year. It fails in this objective because it mixes pay earned in the prior year or current year and the estimated accounting expense of equity-based incentives granted in the current year that may or may not be earned, depending upon the company's performance in future years. Consider the following points with respect to the current Summary Compensation Table (see Table 1):

Table 1

The Summary Compensation Table as Required by the SEC's Disclosure Rules

Name/Position (1)	**Fiscal Year** (2)	**Salary** (3)	**Bonus** (4)	**Stock Awards** (5)	**Option Awards** (6)	**Non-Equity Incentive Plan** (7)	**Chg in Pension Value** (8)	**All Other Comp** (9)	**Total** (10)

- Salary and Bonus. The "salary" and "bonus" columns (columns 3 and 4 in Table 1) list amounts actually earned for the prior year. Under SEC rules, the bonus amounts disclosed in column 4 are annual incentives earned under a discretionary bonus payout. Annual incentives based upon the achievement of pre-established performance targets are reported in column 7 (termed "performance-based" incentives).
- Annual and Long-Term Incentives Paid in the Current Year. Performance-based annual and long-term incentives paid to executives in the prior year are combined in the same column (column 7 in Table 1). This makes it difficult to discern the amount of the payments that correspond to performance over the prior year (from annual incentives) as distinct from long-term incentive payments corresponding to performance over multiple years ending in the prior year (from long-term incentives) without doing substantial calculations from other tables in the proxy statement.
- Unvested Stock and Option Awards Granted or Outstanding. Stock-based incentive awards and stock option awards (columns 5 and 6 in Table 1) are accounting estimates, not actual pay. These amounts represent a portion of the financial accounting estimate of the future value of equity-based long-term incentives and are spread over the vesting period of the awards. The estimates are included in total compensation for the prior year (column 10), regardless of whether these incentives will actually be earned and without

actual knowledge of the amount of compensation executives will realize at the end of the performance period (the actual gains realized from stock-based incentives is reported in the proxy Table entitled "Option Exercises and Stock Vested").

Adding actual pay and potential pay to arrive at a "total compensation" number for a given year mixes apples and oranges in a number of ways. It distorts the relationship between actual pay and actual results on one hand, and it confuses the relationship between potential future pay and the corresponding required performance to earn such future pay on the other.

Current Formulation Criticized by Activists, Media, Consultants. The current formulation of the Summary Compensation Table has been widely criticized by institutional investors and analysts alike from different perspectives. For example,

- TIAA-CREF noted: "Our view is that executive compensation disclosure and financial reporting are separate and distinct. … We believe this approach is less effective from a governance perspective. One of the serious practical consequences would be reduced comparability. For example, the value reported for two executives who receive identical equity awards could be significantly different depending upon non-financial factors such as their retirement eligibility."[1]
- The AFL-CIO stated: "The methodology used to calculate total compensation in the Summary Compensation Table is extremely important to shaping behavior by compensation committees and investors. … This [Summary Compensation Table] approach will conceal from investors the full impact of compensation committee decisions for the most recent fiscal year."[2]
- The Council of Institutional Investors stated: "Many institutional investors countered that the SEC's formula could yield a distorted picture of equity and total pay and makes analyzing pay over time and against peers extremely difficult. It also obscures the compensation committee's decisions about options for top executives in a given year."[3]
- The Council of Institutional Investors also reported that "Compensation firms such as Equilar and Mercer and media organizations like the Associated Press (AP) rejected the SEC's methodology for totaling up

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[1] Letter from John Wilcox, Senior Vice President, Head of Corporate Governance, TIAA-CREF, to the U.S. Securities and Exchange Commission, Jan. 16, 2007, last viewed at http://www.sec.gov/rules/proposed/s70306/s70306-788.pdf.

[2] Letter from Richard L. Secretary-Treasurer, AFL-CIO to the U.S. Securities and Exchange Commission, Jan. 29, 2007, last viewed at http://www.sec.gov/rules/proposed/s70306/rtrumka2425.pdf

[3] Council of Institutional Investors, The SEC's 2006 Executive Compensation Disclosure Rules: An Overview and an Assessment of First-Year Compliance, December 2007, *available at* http://www.cii.org/UserFiles/file/resource%20center/publications/sec%20pay%20rules%20white%20paper%202007%20FINAL-AB%20_2_112607.pdf.

> option awards. Many also disagreed with other aspects of the SEC's total pay formula and devised their own definitions. As a result, consensus on what constitutes "total compensation" remains elusive."

The Center agrees with these organizations that the current formulation of the Summary Compensation Table does not accurately provide an accurate picture of total compensation for a given year, nor does it assist in determining an accurate comparison of pay and performance. Because the accounting estimates of the potential value of equity-based long-term incentives represent an opportunity to earn compensation in a future year, adding them to the actual compensation received in the current reporting year will still result in a total compensation number that mixes apples (current year pay) with oranges (the estimate of potential future pay).

SEC's Original Total Compensation Approach Also Criticized. Even before the SEC changed its approach in late 2006 to require that the Summary Compensation Table mirror the financial accounting expense for equity-based incentives, its approach still mixed apples and oranges. In its proposal to require a total number in the Summary Compensation Table, the Commission required that stock and option awards be shown in the Table at the full grant date fair value (e.g., the full estimate of the present value of what may be earned in the future, as calculated under a Black-Scholes or other valuation method). This still mixed an estimate of future potential pay with current actual pay.

This original approach was criticized by Paul Hodgson of The Corporate Library, who wrote:

> The SEC is proposing that a new Total Compensation figure, that will be shown in the newly-designed Summary Compensation Table, will include a mix of both current, actual compensation and future, uncertain compensation. This is all the more difficult to understand because the commission clearly understands that the proposed Summary Compensation Table is largely intended to present compensation paid currently, current earnings from other compensation plans, and "the dollar value of all other amounts earned during the fiscal year pursuant to incentive plans." Why, then, should it also include amounts "awarded" in the year but not earned?[4]

The Commission recently proposed to return to the approach that Mr. Hodgson criticized above. Although this approach eliminates some of the anomalies that complicate comparisons, such as full vesting of grants for retirement-eligible executives, it still compares current actual with future potential pay. Until the SEC revisits the Summary Compensation Table or requires supplemental disclosure to facilitate an understanding of actual pay and performance, the total number in the table will be flawed, as the SEC acknowledges.[5] In the meantime, companies are encouraged to

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[4] Letter From Paul Hodgson, Senior Research Associate, The Corporate Library to the U.S. Securities and Exchange Commission, March 10, 2006, *last viewed at* http://www.sec.gov/rules/proposed/s70306/phodgson032706.pdf.

[5] U.S. Securities and Exchange Commission, Proxy Disclosure and Solicitation Enhancements, Release Nos 33-9052; 34-60280 (July 1, 2009), at 18-19 ("A further significant reason for adopting the current

clearly and succinctly disclose actual pay and potential pay separately. This approach will help eliminate much of the confusion around what named executive officers actually earned during a given year and enable shareholders to better assess the relationship between pay and performance as well as the potential pay that may be earned for future performance.

The Center's Proposal for Disclosing Actual Pay and Actual Performance

The Center proposes to clarify the relationship between pay actually earned in the reporting year and performance that produced such pay by including a short disclosure and straightforward description that compares these two measures. The disclosure could be made in the form of a table the CD&A. (See Table 2.)

The short disclosure would list and explain:

- salary
- annual incentive
- payouts of long-term equity or long-term cash incentive plans
- total compensation actually earned in the reporting year.

Each of the rows of the table would describe the location of these elements in the Summary Compensation Table, and the columns would provide the total amount, annualized amount (if a long-term award), and a description of what was rewarded and why.

<u>Salary Disclosure</u>. The salary disclosure element would describe how the company sets the salary level in reference to the company's peers (e.g., at the 50^{th} percentile). It would also disclose whether there was a change from the prior year, why the change was made and the total salary.

<u>Annual Incentive Disclosure</u>. The annual incentive disclosure would reiterate the performance measures on which the annual incentive was based. It should disclose performance actually achieved as a percentage of targeted performance. Where practicable, companies should also disclose information about the executive's level of performance. Such disclosure should not be made if disclosing performance targets would be competitively harmful.

<u>Long-Term Incentive Payout Disclosure</u>. The long-term incentive disclosure would provide the earnings from long-term incentive plan payouts that the executive received in the reporting year. The disclosure would provide the total payout, incentive measures on which performance payouts received in the prior year were based and the time period over which the incentives were earned. The table would also discuss the performance actually achieved in relation to targeted performance. The narrative in the table would provide an annualized value (total payout divided by the period over which the incentive was earned) for the long-term incentive. It would explain that the total incentive was earned over several years, and thus technically, the annualized gain is

rules was concern that disclosing the full grant date fair value would overstate compensation earned related to service rendered for the year, and that actual amounts earned later could be substantially different. However, companies have recognized that the current rules also have the potential to over-report compensation for a given year.").

the amount that was earned in the current year. However, because the annualized gains from other years are not reported elsewhere, the total payout is included in the table. Overall, this approach would separate long-term incentive payouts from annual incentive payouts and allow shareholders to understand the elements of actual pay for the year in question and the performance upon which such payments were based.

Equity Compensation Disclosure. The table would also include the amount of equity compensation earned in the reporting year from stock option exercises and vesting of restricted stock.

Stock Option Exercises. As with long-term incentive payouts, the table would report the amount of compensation realized for the reporting year from stock option exercises. The narrative in the table would report the total gains upon the exercise of stock options, the stock price appreciation which generated the gains and the period over which the options were outstanding. The value of the amount attributable to the current year (an annualized amount) would be included in the narrative, because the total realized through exercising was earned over the period the option was held.

Restricted Stock Vesting. Similarly, the value of the amount realized through the vesting of restricted stock would be reported, and an annualized amount would be provided in the narrative because the total amount was earned over multiple years, not just the year in question. The narrative in the table would disclose the appreciation in stock price over the period as well as the vesting period.

Total Actual Compensation Earned in the Prior Year. The amounts from the individual elements of actual pay would be totaled, thereby providing a snapshot of the actual pay earned during the prior year, the performance generating such pay, and the time period over which pay was earned. An annualized total would also be provided so that the amount actually earned in the current year is disclosed.

To provide completeness of disclosure, perquisites and other non-performance-based compensation would be disclosed in the Summary Compensation Table, but would not be included in the discussion of performance-based compensation. If the Summary Compensation Table were revised, the SEC should separate performance-based compensation from amounts such as perquisites that are not based on performance.

The Center's Proposal for Disclosing Potential Future Pay and Required Performance

The second part of the Center's proposal is aimed at clearer disclosure of long-term incentives granted in the prior year. Since such awards are contingent upon future service and performance, the Center believes that they should not be included in the total compensation reported in the Summary Compensation Table (column 10). Until the Summary Compensation Table is modified in this way, we recommend that accounting estimates of the equity granted in the current year, and/or that which is outstanding and unvested from prior years' awards be disclosed, along with performance required to achieve those estimates. As with the current year compensation, the Center proposes to clarify potential future pay amounts by including a companion disclosure in the form of a short table in the CD&A. (See Table 3.) There are three elements to this disclosure:

- An explanation of the meaning of the values in the Summary Compensation Table.
- A performance award disclosure, including:
  - the future service and performance required to achieve the equity-based incentives;
  - a stock option disclosure;
  - the total financial accounting expense estimate of performance awards and stock options.
- The stock price appreciation required to realize compensation equal to the accounting expense disclosed in the Summary Compensation Table.

Each of these is discussed below.

Describe What the Summary Compensation Table Values Mean. The first element of the disclosure is a short narrative that explains that the values in the stock and options tables are accounting expense estimates related to the years over which the awards vest. This description would carefully explain that the numbers in the table do not reflect actual earnings, but are estimates of potential future earnings if performance is achieved. It should state that actual earnings will be determined only when the awards vest, if at all.

Performance Awards Disclosure. A second disclosure under future pay and performance addresses performance awards, such as performance shares, performance share units, and performance-vested restricted stock and restricted stock units. For these types of awards, the company would list the performance that would need to be achieved under each form of award to reach the estimated payout for each year in which an award is outstanding in the Summary Compensation Table.

Descriptions of the performance would vary by company because of differences in the equity devices used. For example, in describing performance based on relative total shareholder return, the company would describe how the performance relates to the company's peer group, such as at, above or below the median of the peers. As with the annual incentive disclosure, specific financial targets should only be disclosed if they are already disclosed elsewhere or if such disclosure would not result in competitive harm.

Stock Options Disclosure. Companies would provide a similar disclosure for stock options. The disclosure would list the grant date of the options, and the grant date stock price. For each tranche, the company would report the required increase in stock price over the grant date price that would produce the estimate shown as an expense for the award in column 6 of the Summary Compensation Table. To give a good estimate of performance, the company should also list the total increase in shareholder value of the potential stock price increase if performance is achieved. For example, if the Black-Scholes value is 40 percent of the stock option award, the stock would have to appreciate by 40 percent over the vesting period to make this a true reflection of future pay.

Total Financial Accounting Estimate of Awards. The disclosure would include the total financial accounting estimate of each type of long-term incentive award. Performance-based award estimates would be valued at target performance and for stock options and restricted stock the grant date fair value accounting estimate would be disclosed.

This approach makes it clear that the equity-based incentives are an estimate rather than actual pay. However, the approach also gives shareholders a clearer view of the level of performance required to receive the compensation and thereby makes explicit the pay for performance linkage of equity-based incentives.

Conclusion

The increased focus on executive compensation will lead to more intense scrutiny of the relationship between pay and performance. By adopting these relatively simple approaches to disclosure, companies can make that connection clearer for shareholders, while providing a useful contrast between the information in the Summary Compensation Table and what executives actually earned.

Table 2: Comparison of Actual Pay Earned in 2008 to Actual Performance*

Form of Compensation	Time Period Covered	Total Received ($)	Annualized Amount	Performance Results Over Performance Period That Produced the Compensation
Salary	2008	$1,000,000	$1,000,000	The company generally targets salary for all executives at the 50th percentile of peer group companies. Based on this analysis, no adjustment was necessary for 2008.
Annual Incentive	2008	$1,800,000	$1,800,000	2008 EBITDA increased by 11.4% over the prior year and exceeded the targeted level of performance. Free cash flow from continuing operations increased by 7% over 2007, totaling $3.3 billion and exceeded target. The Compensation Committee assessed that accomplishment of other targeted corporate objectives, which are not disclosed due to competitiveness concerns, fell short of expectations.
Long-Term Incentive Payout	2006-2008	$6,450,000	$2,150,000	The total three-year payout for the Long Term Incentive award was earned over the performance period 2006-2008 and produced a total payout of $6,450,000, or $2,150,000 per year. Performance criteria for this award were: (1) EPS growth, weighted 50%, which exceeded the targeted level; (2) Opening new markets in key strategic regions, weighted 25%, which was not achieved at the targeted level, and (3) Total return to shareholders vs. peer group companies, weighted 25%, for which the company ranked 8th out of the 15 peer companies, producing a payout at target for this component. Overall the payout represented 105% of target.
Equity Compensation				
Stock Option Exercises	2000-2008	$8,000,000	$1,000,000	The gains upon exercise of stock options in 2008 were $8 million, based upon stock price appreciation between 2000 and 2008. During that time, the stock price appreciated from $15 to $35 per share. Because the $8 million was earned over the 8 years the award was outstanding, the annualized gain (i.e., the gain spread equally over the period the options were held), is $1 million per year, thus accurately reflecting the performance period.
Restricted Stock Vesting	2003-08	$4,500,000	$1,500,000	Similarly, the value of the vesting of restricted stock was $4.5 million, and was earned over the three-year period from 2004 and 2007. Because the total gain was earned based on stock over the three-year vesting period, the annualized gain (i.e., the gain spread equally over the vesting period) is $1.5 million.
Total Actual Compensation Earned in 2008	2000-2008	$21,750,000**		See explanations under Salary, Annual Incentive and Long-term Incentive boxes above. The annualized amount represents the amount actually earned in 2008 and includes the annualized gain for LTIP payout, stock option exercises and restricted stock, as well as total annual salary and annual incentive.
Total 2008 Annualized Compensation			$7,450,000**	

* Sample disclosure for illustrative purposes only.

** Total Actual Compensation does not include the value of perquisites, as they are not related to performance. Total perquisites for the year were $450,000

Table 3: Potential Incentive Earnings For Future Performance*

The numbers in the stock awards and option awards columns of the Summary Compensation Table do not reflect what the named executive officers actually earned in 2008. Instead, the numbers are estimates of the accounting expense recognized for those awards in the current year. In contrast, the values presented below are based on the estimates of the company's total accounting expense if performance is achieved, as listed in the Grants of Plan-Based Awards Table. At the vesting date, the compensation earned by the executive may be nothing or it may be greater than the estimates in the Proxy Statement, based on the executive's and the company's performance, and the value of the equity.

The Table that follows explains the performance that is required to be achieved to earn the estimated values of stock awards and option awards granted in 2008 and listed in the 2008 Grants of Plan-Based Awards Table.

Year of Award	Type of Long-Term Incentive Award	Performance Period/Vesting Period	Performance Criteria	Financial Accounting Expense Estimate	Description of Linkage Between Performance Criteria/Objectives and the Creation of Shareholder Value
2008	Performance Shares	2008-2010	• 50% EPS Growth • 50% Company's total Shareholder Return compared to the median TSR of peer group companies	• Total estimated pay from EPS at target** = $XX • Total estimated pay from TSR** = $XX	EPS is a key measure of the profitability of the company and indicates after-tax return generation of the company. Total Shareholder return demonstrates our ability to create value compared with peer group competitors.
2008	Stock Options	2008-2010	Share price appreciation	Total grant date fair value = $XX	Stock options align the interests of management with shareholders through share price appreciation. Under company policy, executives are also required to retain 50% of the shares remaining upon exercise of a stock option after paying taxes and exercise costs, further continuing the alignment. To realize compensation equal to the accounting expense shown in the Summary Compensation Table for this award, the price of our company's shares would need to appreciate by 33% over the grant date stock prices of $9.44 during the vesting period. All shares vest after four years.

* Sample disclosure for illustrative purposes only. Each company's disclosure would have to be customized to its incentive plans.

** The Center believes the SEC Division of Corporation Finance staff's recent change in interpretation requiring performance-based awards to be shown on the Grants of Plan-based awards at maximum rather than at target would create unnecessary confusion and inconsistencies with other reporting. For this reason, the Center believes that reporting performance-based awards at target is the best approach.