September 15, 2009

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: Comments on SEC Proposal on Proxy Disclosure and Solicitation
Release Numbers 33-9052, 34-60280, File Number S7-13-09

Dear Ms. Murphy:

The Center On Executive Compensation is pleased to submit comments to the SEC on its proposed release on Proxy Disclosure and Solicitation Enhancements.[1] The Center believes that the Commission has raised essential issues. We urge the Commission to approach finalizing the release by taking pragmatic approaches to address the disclosure of risk in incentives, the linkage between pay and performance, and the other issues raised in the proposed release.

As you may know, the Center On Executive Compensation is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of the senior human resource officers of leading companies. The Center is a division of HR Policy Association and currently has over 60 subscribing companies representing a broad cross section of industries. Because the senior human resource officers play a unique role in supporting the compensation committee chair, we believe that our Subscribers' views can be particularly helpful in understanding how executive compensation plans are constructed and executed, how risk is appreciated and mitigated by the Compensation Committee, and how to more effectively align pay and performance.

I. Executive Summary

The Center applauds the Commission for addressing particularly difficult issues raised in part by the financial service meltdown, the need for greater clarity in disclosure and concerns about compensation committee independence. The following provides the highlights of our comments.

- **Disclosure of Risk in Compensation**. The Commission's proposal for disclosure of risk in compensation plans for employees below the named executive officer ("NEO") level should apply exclusively to the financial services industry because of the different structure of compensation in that industry and that the Commission's examples appeared to focus primarily on that industry. If the Commission decides to apply the proposed disclosure to all companies, it is recommended that the standard for disclosure be clarified to include disclosure

[1] Securities and Exchange Commission, Proxy Disclosure and Solicitation Enhancements, Release Nos 33-9052, 34-60280, 74 Fed. Reg. 35,076 (July 17, 2009).

only where an incentive plan "is material" rather than where it "may be material" to the company. In addition, the Center believes that absent clarification of the scope of the proposed disclosures, the Commission's proposal could greatly expand the length of the Compensation Discussion and Analysis without measurably improving the disclosure of useful information. For this reason, the Center recommends that the proposed disclosures only apply to NEOs or senior executives for which incentives cover a greater proportion of overall compensation. Executives also have a greater level of responsibility over the company or particular aspects of it and thus have the ability to have a significant negative effect on the company. The Center encourages the Commission to provide greater clarity as to the types of arrangements that trigger disclosure by references to best practices such as are included in the Center's risk checklist. It also recommends that if additional disclosures are triggered, they should be limited to a discussion of the general process followed by the compensation committee in taking steps to mitigate the potential that the program would encourage risk that would have a material effect on the company.

- **Summary Compensation Table Changes**. The Center supports the Commission's change of the valuation of stock and options on the Summary Compensation Table from the current financial accounting method to a grant date fair value approach. The current approach is confusing for companies and investors alike. However, the Center believes the Commission's actions do not go far enough and that, at a minimum, the CD&A should be streamlined to include two new tables at the front that provide investors with a clearer pay for performance view. One table that links current actual pay with the performance required to generate it and another that discloses the grant date fair value of long-term compensation and the performance required to receive the estimated amounts in the future.

- **Compensation Consultant Disclosure**. The proposal for compensation consultant disclosure will address investor skepticism over potential conflicts of interest for consultants that do work for both the Board and the company. The Center urges the Commission to provide an exemption for consulting firms that provide executive compensation data to the Board, but do not provide any other advice.

The Center looks forward to working with the Commission toward a practical implementation of its release and to further promote our approach to linking pay and performance.

II. Proposed Risk Disclosure

The Commission has proposed to expand disclosure of compensation in the proxy considerably to cover "how the company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk." [2] The Center recommends that:

- The Commission should consider applying its proposed expanded disclosure of risk in the CD&A exclusively to the financial industry, because of the unique approaches to compensation in that industry and the fact that the release included examples that appeared focused on problems in the financial industry. Companies outside the financial industry that maintain compensation structures that can materially impact risk are already required to describe those risks in the "Risk Factors" disclosure required in Item 1A of its annual reports on Form 10-K.
- Regardless of whether the Commission limits the proposed disclosure to the financial industry or all companies, consistent with the current rules applicable to the CD&A disclosure of risk as relates to incentive arrangements for NEOs, the Commission should limit disclosures to compensation structures that "are material" to the company rather than those that "may have a material effect" on the company, which is a vague and substantially broader standard that will cause companies to expand risk disclosures in the CD&A, even if not material to investors.
- If the Commission decides to apply its proposed disclosure to all companies, it should clarify that the circumstances triggering disclosure are limited to pay arrangements applicable to executive officers and certain other highly paid employees, e.g., only to the company's NEOs, as determined by reference to well-established best practices, such as the Center's checklist on risk and incentives.
- If the operation of a compensation program or structure is determined to be material to the company, the disclosures required should be limited to a discussion of the general process followed by the compensation committee in taking steps to mitigate the potential that the program, policy or practice encourages risk that would have a material effect on the company.

A. Business Strategy Is the Primary Driver of Risk in a Company

As a framework for the following discussion, the Center believes that compensation plans are not the prime driver of risk in a company. Instead, business strategy and the performance objectives against which individual and group performance is assessed establish the risk profile of the business. The riskier the business strategy or performance objectives, the more important the structure of the compensation plans. A moderate

[2] *Id.* at 35,082.

business risk coupled with a moderate compensation plan will pose less overall risk, while a risky business strategy coupled with a highly leveraged[3] and unbalanced compensation plan is a toxic cocktail and may encourage incentive participants to "swing for the fences" in pursuit of higher incentive payouts, regardless of the long-term effects on the company. For this reason, the Center agrees with the Commission's focus both on the role of risk in the overall business strategy and the impact of compensation. We urge caution, however, in assuming that risk flows inherently from compensation practices versus risks that are indeed inherent in the pursuit of virtually any business strategy, particularly for the vast majority of incentive participants below the senior most levels of the company.

B. Expanded Risk Disclosure Should Be Limited to the Financial Services Industry

The Center urges the Commission to limit the proposed expanded disclosure to the financial industry because of that industry's history of business strategy and incentives. There are several important reasons for our recommendation:

- The primary driver of the Commission's release appears to be the impact of compensation policies in the financial services industry on the overall economic downturn and "the current market turmoil."[4]
- The release notes that compensation programs in the financial industry did not have the balance between long-term and short-term incentives that is typical for general industry, nor did they have the typical limitations on incentive compensation plans, such as caps on potential payouts. In fact, the Commission's release states that "at a number of large financial institutions the short-term incentives created by their compensation policies were misaligned with the long-term well-being of the companies."
- Highly leveraged compensation plans went deeper into financial services firms than is the case for most companies in other industries. In the financial services, mid-level employees were trading or selling highly complex financial products that could saddle the company with significant liability for potentially many years into the future, and many were earning annual compensation many times the amount of their respective annual base salary. In other industries, compensation structures commonly cap potential awards for all executives and the time period over which incentives are earned is much more directly aligned with the risk horizon of business decisions.
- The examples of compensation structures and arrangements in the Commission's release mirrored those in the financial industry and problems at

[3] "Leverage" as used here means the incremental payout from additional increments of performance. Highly leveraged plans provide significant additional compensation from additional units of performance while non-highly leveraged plans provide more moderate compensation for each additional unit of performance.
[4] 74 Fed. Reg. 35,082.

firms, such as AIG, where compensation has been identified as playing a significant role risk taking that led the company's decline. These examples are not directly applicable to companies in other industries.

- Item 503(c) of Regulation S-K already provides a mechanism for the disclosure of compensation practices that constitute a material risk to reporting companies. While the Commission understandably wishes to further highlight certain compensation practices among financial companies in the CD&A in light of recent events, requirements already contained in existing rules (e.g., Item 1A of Annual Reports on Form 10-K) will ensure that non-financial companies fully disclose the impact of its compensation practices on overall risk where material.

Because of the unique compensation structures in the financial services industry that have historically favored shorter-term compensation, combined with the potential that employees below the named executive officer level could structure transactions that incurred long-term risk for the company, and the fact that the financial services industry is at the center of the economic turmoil the country is experiencing, the Center urges the Commission to limit the application of the expanded disclosures to that industry. In determining whether disclosure is required and the types of disclosures to make, the Center suggests that the Commission follow the Center's checklist for risk in incentives, attached as Appendix I and discussed further below.

C. Clarify the Material Effect Standard

Regardless of whether the new disclosure requirement applies to the financial services industry or to all companies, the Center believes that the Commission should only require disclosure of compensation plans or policies that contain risks that "are material" to the company rather than those that "may be material." The Commission's standard as proposed is considerably broader and hence more difficult to apply than the requirement for disclosure of material information under its 2006 amendments. The Center is concerned that the Commission's requirement will result in more voluminous and costly disclosure without measurably improving the understanding of risk in compensation.

The Commission's proposed "may be material" standard is particularly difficult to apply when addressing the issue of incentives and risk because the actual effect of the incentive will not be known until after the incentive period, often three or more years in the future. Yet, disclosure would likely be required in the year the incentive was established. By adopting the "may be material" standard, it appears that the Commission was attempting to recognize the contingent nature of incentives. However, another reading of the phrase, and one that is more likely to be adopted by companies seeking to ensure total compliance, is that disclosure is required for any incentive plan that *may potentially* be material to the company as a whole because it *may potentially* encourage an employee to take excessive risk that would have a material impact on the company. Given the prospective nature of incentive compensation, such a vague standard as "may be material" would require compensation committees to review and document speculative and often theoretical notions about future actions that may occur within the enterprise irrespective of the actual compensation design or practices in place to mitigate risk. This reading would require compensation committees to review countless pay arrangements and likely lead to considerably more disclosure without producing greater insight for investors, regulators or other constituents.

A Material Effect Can Only Exist If the Compensation Plan in Question Has a Significant Impact on the Company as a Whole. The Center believes that the Commission should apply its established concept of materiality in determining whether additional disclosure is required under the proposal. Under this standard, disclosure should only be required if the information would be useful to an investor in making a decision to invest in the company or in making a determination whether to vote for directors.[5] Applied to incentive plans, a compensation plan may only have a material effect[6] if the risks taken by executives or other employees to achieve the incentive in the plan or policy would have an impact on the company as a whole.

Size Is a Key Component When Determining the Impact of Risk in Incentives. Size matters in determining the impact of compensation programs on risk. For example, a risky business strategy and highly leveraged pay plan applicable to executives in a tiny division of a global corporation is not likely to have a material effect on investors' decision to vote for directors or invest in the company (provided that the risks inherent in such practices are generally confined to the division). On the other hand, the intricate combination of a risky business strategy and off-balance sheet transactions and compensation arrangements, such as those employed in Enron Energy Trading or in the bonus structure of AIG Financial Products, would most likely be deemed to be material because of the impact the plans had on the company as a whole.

The Center is concerned that the Commission's proposal may lead to the proliferation of disclosure that would be perceived by investors to be confusing and irrelevant, absent clarification of the materiality standard. The Commission's examples that focus on the impact of incentive plans on business units do not focus on the impact to the company as a whole and us would not be helpful for an investor whose decisions are based upon an assessment of the company as a whole.

D. Limit Required Disclosure to Executives and Provide Clear Examples of the Types of Material Impact That Trigger Disclosure

The Center recommends that the Commission's final release should provide a broader array of clearer examples of the types of compensation arrangements, within the financial services sector and, for general industry (if the release applies to all companies) that would trigger disclosure. We believe that the disclosure should focus on the compensation for the named executive officers ("NEOs") because their compensation arrangements typically include broader incentive arrangements that potentially could have a material effect on the company.

[5] *Basic v. Levinson*, 485 U.S. 224 (1988) and *TSC Industries v. Northway*, (1976).
[6] The Center reads "may have a material effect" as "may have a material negative effect" because the purpose of the disclosure is to determine whether risks in compensation plans may have negative effects on the value of the company or future long-term prospects for the company.

When viewed across industries outside of the financial sector, the potential for such risk taking among the general employee populations is typically the highest among the NEOs because 70-80 percent of their total annual compensation opportunity consists of incentive compensation. The NEOs also have the greatest ability to impact the overall operation of the company as a whole. Further, the proportion of incentives in the annual pay package and the ability to impact the company directly increases with the executive's level in the organization thereby making the disclosure of risk in incentives more important for investors.

The ability to impact the company decreases with the less senior executives, and the compensation plans below the level of the NEOs commonly have a much lower portion of total pay at risk based upon performance of the given firm. In making decisions about compensation plans,[7] the compensation committee (regarding NEOs) and the human resources department (for lower level executives) should seek balance between incentivizing behavior that will grow shareholder value over the long-term while protecting against behavior that could have a negative effect on the firm. Disclosure in the proxy should only be required where that balance does not exist within the compensation structures established for the NEOs.

In most industries, the level of risk driven through compensation or the performance objectives for individuals or groups of individuals at lower levels of the organization is relatively small. Compensation programs tend to be simpler, more heavily weighted toward salary and, where incentives exist, they tend to be based on sales commissions, group or individual performance. Provided the underlying risk of the product or service being sold or the authority delegated to the employee does not itself pose risks to the company, (e.g., a commission is paid for each individual product or service without the ability to negotiate terms), the risk inherent in such compensation plans would be very small, and disclosure should not be required.[8]

In the final release, the Center encourages the Commission to provide more examples of the types of situations that would trigger disclosure and to provide clearer illustration as to what the specific triggers may be. The Center recommends that it take the following factors into consideration based on the examples in the proposed release:

- Disclosure of compensation policies at a business unit should not be required unless they will have a material effect on the company as a whole.
- Profitability of a business unit, taken alone, is not likely to drive excessive risk taking if the compensation plans are balanced. The trigger for disclosure

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[7]The compensation committee closely reviews the compensation arrangements of the NEOs and the next two levels of senior executives. The human resources department does the same for middle and lower-level executives,

[8] Risk may be a concern where an employee has the authority to negotiate the terms of a transaction, such as a sale of a product or products, to structure a financial transaction or to provide credit or discounts. In these cases, employees may negotiate terms that drive incentives and that potentially jeopardize an element of the company's business, such as gross margins or engage in fraud to generate incentive payments. Disclosure in these cases may be required if the company's internal control processes did not otherwise account for them.

should be a combination of a highly profitable business unit that represents a significant portion of the overall company's profitability and compensation plans designed to further drive profits to the extent that certain types of employees (e.g., traders or underwriters), executives or other high-level employees could be driven to take excessive risks in order to sustain or increase the profits and thus increase their own compensation.

- Compensation expense is only an indicator of material risk where the incentive plans themselves are highly leveraged or otherwise unbalanced. Certain businesses will have compensation expense that is a significant portion of revenues with little chance that the compensation policies will have a "material effect" on the company as a whole. This is not uncommon, for example, in the retail sector or in the service industries. Yet, the risk attributable to compensation in these sectors is very low. Therefore a focus on total compensation expense is misdirected and the appropriate focus should be on the potential variability of compensation expense based upon performance. Variability is the highest in those incentive arrangements that are uncapped and highly leveraged.

In developing its revised examples of circumstances that may trigger the new disclosure, the Center urges the Commission to reference current best practices, as articulated in the attached checklist on mitigating excessive risk in executive compensation plans. While the full checklist is attached as an appendix to these comments, but several elements bear specific mention. These include:

- *The Relationship Between Performance and Incentive Plan Payouts Should Be Within the Range of Competitive Practices, Based on Comparison to a Carefully Chosen Peer Group*. Performance criteria that are set too high may encourage executives to take excessive risk to achieve some level of payout. Performance criteria that are extraordinarily high relative to reasonable expectations of performance may warrant disclosure of the potential of this risk unless other mitigating factors are present.[9] The Center does not believe that issuers should be required to disclose performance targets that potentially could have detrimental competitive effects.

- *The Mix of Compensation Should Be Appropriately Balanced Between Annual and Long-Term Compensation*. One frequently cited element of the financial services industry meltdown was that annual incentives comprised a disproportionate share of compensation for executives and other employees. The Center believes that an annual incentive that comprises more than 50 percent of the executive's total compensation opportunity (which includes salary, annual incentive, and estimated value of long-term incentives) requires greater compensation committee scrutiny and analysis, and may warrant disclosure and re-allocation of a portion of the incentive.[10] In addition, both annual and long-

[9] Incentives set too low may waste company assets by overpaying for the performance required.
[10] Among large companies generally, long-term incentives usually comprise 60 percent or more of total compensation opportunity for senior executives. *See, e.g.,* Equilar, Inc., *CEO Pay Falls 6.8% in First Drop*

term incentive plans should limit total payouts, so that executives are not encouraged to make decisions that maximize incentive payouts to the detriment of the company.

- *The Performance Criteria and the Corresponding Objectives Represent a Balance of Performance and the Quality of Performance*. The performance criteria under both annual and long-term incentive plans should include measures of performance (e.g., financial and managerial goals) and measures of the quality of performance (e.g., return measures or measures of sustainability of performance). This mix helps ensure that executives focus on the long-term sustainability of the enterprise, rather than "blowing out" earnings in a given year to maximize short-term incentive opportunities.
- *Long-Term Incentive Performance Measures or Equity Devices Should Be Balanced to Protect Against Encouraging Excessively Risky Behavior*. Performance criteria and vesting periods of long-term awards that overlap (e.g., a program that involves a new long-term incentive grant each year) will reduce the incentive to maximize performance and payout in any one year.
- *Executives Should Be Required to Retain a Meaningful Portion of Shares Received Through Participation in Long-Term Incentives*. Stock ownership requirements, such as stock ownership guidelines or requirements to hold a percentage of net equity received helps to retain an ongoing link between shareholder and management interests. The ownership requirement should be at a meaningful level but not be so high as to encourage overly risk-averse behavior due to the high concentration of an executive's personal wealth in the form of company stock.

The Center believes that these elements should be included in the Commission's principles-based approach to determining whether disclosure of incentives and risk is warranted. As part of the final release, the Commission may also want to consider an additional approach to determining whether disclosure is warranted based upon certain triggering events such as: If, because of material concerns about risk in compensation, the Compensation Committee or the human resource department makes a change to an incentive program to align the compensation program more closely with the checklist,, disclosure would be required. This "trigger" approach reinforces the purpose of disclosure and provides information to shareholders that may be useful in assessing the company's compensation programs and the Board's decision with respect to such programs while minimizing unnecessary disclosure. Under this approach, only material changes premised on reducing risk that has a material impact on the company would require disclosure, not routine changes to incentive plans.

Since 2002. Bonuses Cut by 20.6%, April 7, 2008, *last viewed at* http://www.equilar.com/press_20090407.php.

E. Disclosures Required If a Significant Potential of Material Risk to the Company Exists From Compensation Plans or Policies

The Commission has proposed the type of information that a company must disclose and analyze in the event it determines that a material risk to the company exists from compensation plans or policies. The Center believes that many companies have already taken steps to disclose how their executive compensation plans mitigate risk and that the Center's risk checklist provides a useful framework for doing so.

If disclosure is triggered, we recommend that the required CD&A disclosure be a simple statement explaining the compensation committee's process for reviewing the potential for excessive risk in executive incentive programs or overseeing compensation plans for certain highly incentivized and highly paid employees. If applicable, the statement should also explain how the compensation program mitigates risk, with reference to those specific elements of the program or mix of compensation mitigate risk.

The Commission also asked whether companies or Compensation Committees should disclose that they have reviewed the potential for risk in compensation and determined that there is no compensation risk that would have a material effect on the company. The Center opposes additional disclosure of nonmaterial information. CD&As are already unduly long, and the precedent of requiring disclosure of the fact that there is nothing to disclose could have considerable undesirable effects on the clarity of information and investor understanding of the information. The Center believes that as an alternative, the Commission could provide, consistent with the Center's comments and checklist, a clearer approach to the process that compensation committees are expected to follow in determining whether additional disclosure is required under these proposed rule.

III. Summary Compensation Table Revisions Reflect Improvement of Flawed Approach, But Further Changes Necessary to Link Pay and Results

The Center supports the Commission's proposed revision to how equity compensation is disclosed on the Summary Compensation Table as a positive and necessary step toward eliminating some of the confusion created by the current disclosure requirements. However, the proposed change does not sufficiently address the mixing of actual current pay and future potential pay that is required to be reported in the Summary Compensation Table, and that ultimately obscures the link between pay and performance. The Center recommends that the Commission go further by either revising the Summary Compensation Table so that investors are provided with clearer disclosure of how compensation and results are linked or require supplementary disclosure in the CD&A that would accomplish the same purpose. We believe that our suggested changes would reinforce the Commission's goals of providing investors with clear, concise and meaningful executive compensation disclosure.

A. The Current Summary Compensation Table Does Not Provide a Clear Link Between Pay and Performance

The SEC's 2006 enhancements to executive compensation disclosure was driven by the premise that investors should be provided with clearer information about how pay and results were linked,[11] yet the current the Summary Compensation Table makes it difficult, if not impossible, for investors to determine if a clear link exists between pay and performance. The Center agrees that the Commission's proposal to disclose the full grant date fair value will clear up one point of confusion, but it does nothing to clarify what was paid, when it was paid, and how those payments relate to performance.

The Summary Compensation Table is intended to provide investors a snapshot of the total compensation paid to the named executive officers in the reporting year.[12] However, the table fails in achieving this goal because the total compensation number mixes pay actually earned in the reporting year with an estimate of future potential pay that may or may not be earned, depending upon the company's performance in future years. The total number is then typically compared to the company's performance in the reporting year, giving an inaccurate snapshot of pay and performance.

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)
		Actual	Actual	Potential	Potential	Actual	N/A	N/A	Mixed
		Pay	Pay	Pay	Pay	Pay			

[11] The instructions to those rules states that the CD&A is to discuss "What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions" and "How specific elements of compensation are structured and implemented to reflect these items of the company's performance and the executive's individual performance." *See, e.g.,* U.S. Securities and Exchange Commission, Executive Compensation and Related Person Disclosure, Release Nos. 33-8732A, 34-54302A, 71 Fed. Reg. 53,157, 53,165 (September 8, 2006).

Likewise, the current proposed revisions to its disclosure rules are to provide additional information the Commission believes would be useful to investors in assessing the linkage between pay, performance, and risk. *See, e.g.* Preamble 74 Fed. Reg. at 35,078 ("For example, if a particular business unit that carries a significant portion of the company's overall risk is significantly more profitable than others within the company, compensation policies relevant to employees of that unit could be just as essential to the company's overall financial condition and performance as those of its senior executives.").

[12] 71 Fed. Reg. 53,159 (Sept. 8, 2006).

The following explains in more detail why the current Summary Compensation Table does not provide a clear understanding of pay for performance in the short- and long-term.

- **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 current and prior years' 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").

The Center acknowledges that investors seek to compare compensation across companies and industries. Yet, total compensation in the Summary Compensation Table is meaningless for that purpose. Incentive compensation, as it is required to be reported is the primary reason for this disconnect. The total number does not relate back to the company's past performance or explain the performance required to achieve the estimates reported in the table for new equity awards. The lack of a logical connection between the compensation reported in the Summary Compensation Table and the actual pay has caused companies to include alternative tables in the CD&A and news organizations to develop their own methodologies for determining total pay in a given year, further illustrating the need to reexamine how the Summary Compensation Table is structured and how pay and performance can be assessed under current disclosure requirements.

For example, companies ranging from General Electric to Kodak to Sun Trust Bank have included supplemental tables that illustrate the actual pay received in the reporting year as opposed to the amount reported in the Summary Compensation Table based upon the grant date fair value. Along these lines, news organizations such as the *Wall Street Journal* and the *New York Times*, among others, have developed proprietary methodologies for how they report total compensation. For example, on April 1, Reuters reported that Macy's CEO earned $5.4 million in 2008[13] while the Associated Press reported that he earned $14.82 million.[14] Both estimates were made using the reporting included in the companies' proxy disclosures. Reuters made the estimate based upon actual pay received, while the Associated Press made the estimate using the grant date fair value of equity awards, even though they were contingent on future performance.

Reporters and investors are turning to their own calculation of pay for performance because the Summary Compensation Table and the CD&A currently do not provide an adequate picture by themselves. With potential policy changes being considered that put the pay for performance connection at a premium, a clearer disclosure of the link between pay and results would simplify the analysis of executive pay plans. Unfortunately, the SEC's proposed changes fall short of accomplishing this objective.

B. SEC's Proposed Changes Fail to Clarify the Link Between Pay and Results

The Center believes that using the Commission's current financial accounting approach to equity valuation is confusing for investors for several reasons:

- The value of equity grants in the table do not reflect actual payouts from prior grants or the estimated total value of grants made in the current year, but a pro-rata share of current and prior grants spread out over the vesting period. This requires investors to look at other tables to calculate the total grant date value of equity compensation for the current year.
- The financial accounting approach treats equity granted to retirement-eligible executives as vested in the year of grant. Thus, for these executives, the total grant date value is included in the Summary Compensation Table as opposed to non-retirement eligible executives, who recognize only the pro-rata share. This approach is more likely to cause changes in the composition of the NEOs, and makes comparability of total compensation among companies and executives even more difficult than it otherwise would be.
- Under the financial accounting approach, the value of certain performance-based equity is marked to market during the vesting period to account for fluctuations in the underlying market value. During times of significant volatility, this can result in negative numbers being disclosed on the equity columns of the Summary Compensation Table, and even cause some companies to report a negative total compensation number.

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[13] Aarthi Sivaraman, "Macy's CEO Awarded $5.4 Million in 2008," *Reuters*, Apr. 1, 2009, *last viewed at* http://www.reuters.com/article/rbssRetailDepartmentStores/idUSN0150485020090401.
[14] Macy's CEO Got $14.8M Pay Package, *Associated Press*, Apr. 1, 2009, *reprinted in Crain's New York Business Online* at http://www.crainsnewyork.com/article/20090401/FREE/904019969.

The Commission's proposal would address these problems and the Center supports the change for that reason. However, the Commission's changes do not address a primary source of confusion.

The Grant Date Fair Value Approach Obscures Pay for Performance. Under the Commission's proposal, disclosing equity granted on the Summary Compensation Table at the grant date fair value is still misleading to investors for the following reasons.

The total number mixes actual current pay with future potential pay. Executives will not necessarily earn the amount represented by the equity estimates reported in the table. Actual compensation, and thus the comparison of actual pay with actual performance, could be much higher or much lower, depending upon actual results. Even the SEC has noted that the grant date fair value approach overstates compensation.[15]

The current summary compensation table approach provides inconsistent disclosure of decisions regarding long-term incentive compensation. Estimates of earnings under nonequity-based long-term incentive compensation programs are not reported in the summary compensation table. Only actual payouts at the end of the performance period are disclosed. A common refrain from certain investors is that the grant date fair value allows investors to evaluate determinations made by the compensation committee. However, it would seem that the same would be true for nonequity incentive compensation for which only the actual amount earned is reported as opposed to the grant date value.

With these shortcomings in mind, the Center believes that additional changes to disclosure are necessary to disentangle the mix of current and future compensation and to provide investors with greater clarity as to the linkage between pay and performance.

C. The Center's Proposal for Clearer Disclosure of the Linkage Between Pay and Performance: "Pay for Performance at a Glance"

The Center believes that the Commission's proposed changes to the Summary Compensation Table are necessary but not sufficient to facilitate an understanding of actual pay and performance. The Commission has asked for comment on other potential means of disclosing stock and option compensation on the table. The Center has developed a methodology for disclosure that could either be incorporated into the Summary Compensation Table or included as a separate disclosure in the CD&A to clarify the pay for performance linkage and perhaps to streamline increasingly lengthy disclosures.

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

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[15] Preamble, *supra* note 1, at 35,081 ("A further significant reason for adopting the current 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.").

potential pay so that the total compensation number is more meaningful. Alternatively, and easier to implement, the Commission could require companies to include the two short tables explained below at the front of the CD&A for CEOs. The Center believes that this would demonstrate how pay and performance were linked. Limiting such new disclosure to the CEO would avoid unnecessarily lengthening the CD&A been given that the CEO is the leader of the company his or her pay would likely be representative of the company's NEO pay program.

Disclosing Actual Pay and Performance in the Current Year

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 table that includes a straightforward description that compares these two measures. (See Table 2 in Appendix II)

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.

Disclosing Potential Future Pay Compared to Required Performance

The second part of the Center's proposal is aimed at clearer disclosure of long-term incentives granted in the reporting year. Since such awards are contingent upon future service and performance, the Center believes that they should not be included in the total compensation number reported in the Summary Compensation Table. Until the Summary Compensation Table is modified to separate current from future pay, 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 for CEOs in the form of a short table in the CD&A. (See Table 3 in Appendix II) 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;[16]
  - 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.

This approach makes it clear that the equity-based incentives are an estimate rather than actual pay. 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 long-term incentives.

In sum, the increased focus on executive compensation will lead to more intense scrutiny of the relationship between pay and performance. By incorporating these relatively simple tables at the front of the CD&A, the Commission would make that connection clearer for investors, while providing a useful contrast between the information in the Summary Compensation Table and what executives actually earned or has the opportunity to earn based upon future performance. At the same time, the Commission may be able to shorten increasingly long CD&As.

D. Responses to Request for Comment Regarding Technical Matters

The Commission has invited comment on several issues related to the Summary Compensation Table changes. Below, the Center responds to many of those requests, and offers comments on related matters.

<u>Summary Compensation Table Should Include Only Equity Grants Made During the Reporting Year</u>. The Commission has asked whether equity awards granted after the end of the last fiscal year should be reported in the Summary Compensation Table if the grants were made in recognition of service performed during the reporting year (e.g., the last fiscal year). The Center believes that the Commission should retain its current rule that provides for reporting of the equity grants made in the current fiscal year. There is no single approach to account for all equity grant practices, and for this reason, there will always be timing differences where committees choose to grant certain types of equity (e.g., restricted stock) based upon past performance.

<u>Retain the Grant Date Fair Value in the Grants of Plan-Based Awards Table. The</u> Center believes that the Commission should retain the grant date fair value of equity awards in the Grants of Plan-Based Awards Table. The table is necessary to enable shareholders and other interested parties to determine retrospectively whether pay and performance are actually linked. In some cases, named executive officers may receive more than one grant of stock or stock options that would be aggregated under the

[16] Specific performance targets would be disclosed only to the extent their disclosure did not disclose confidential business information, consistent with the Commission's materiality and confidential treatment standards.

Summary Compensation Table. Reporting the awards separately allows a clearer interpretation of pay for performance. Until the Commission adopts the Center's recommended disclosure linking pay and performance, the disclosure of the grant date fair value is important for those who wish to calculate how pay and performance are linked when stock vests or stock options are exercised.

Performance-Based Equity Awards Should Be Valued at Target Payout Rather Than at Maximum. As part of its rulemaking, the Center believes that the Commission should reverse the staff's interpretation of the valuation of performance-based equity awards on the grants table and as disclosed in the Summary Compensation Table. A recent Compliance Disclosure and Interpretation answer from the Staff indicated that:

> The grant date fair value reportable in column (l) is determined based on maximum performance, so that investors can see the maximum grant date fair value numbers that were authorized in granting the award.[17]

The Center believes that this interpretation has the effect of overstating the fair value of a performance-based equity program and if allowed to stand, it will have the effect of discouraging compensation committees from adopting such programs.

The purpose of performance-based equity programs is to incentivize executives to achieve the goals of the program. In most plans, "achievement" means reaching the target goals. Maximum thresholds are designed to cap exposure on total compensation, and help ensure that incentive plans do not motivate excessively risky behavior consistent with sound management of risk in executive compensation. Companies establish the target payout as the reasonable level of payout given a range of expected performance scenarios. Although employees are not expected to achieve maximum performance and corresponding payouts, such payouts are within the range of possible outcomes. Requiring the grant date fair value to be estimated at maximum performance will overstate the compensation committee's intended pay levels and lead investors to believe that the committee sought to pay executives more than it did.

Revising the valuation of performance-based equity plans to reflect target achievement would not take away the information currently available or that would be available to shareholders under the Commission's proposed revisions to the Summary Compensation Table. Disclosure of performance-based equity programs on the Grants of Plan-Based Awards Table already includes the number of shares to be granted at the threshold, target and maximum amounts under the plan. Investors can see the number of shares authorized and easily calculate the total value at the maximum level if they are calculating share usage, as opposed to intended compensation.

Salary Elected to Be Taken in Non-Cash Forms Should Not Be Disclosed in Other Columns. The Commission has proposed in Instruction 2 to Item 402(c)(2)(iii) and (iv) that if an executive has elected to forgo the receipt of salary by taking it in the form of stock, equity-based or other noncash compensation, that the amount forgone be disclosed in the column corresponding to the noncash form of compensation. The Center disagrees

[17] U.S. Securities and Exchange Commission, Division of Corporation Finance, Compliance Disclosure & Interpretation 120.05 http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm, May 29, 2009.

with this approach because it would make it more difficult for shareholders and other stakeholders to determine how pay correlates with performance. If compensation is initially awarded as salary, it should be displayed on the Summary Compensation Table in that form. Otherwise, the columns in the Summary Compensation Table corresponding to the various forms of compensation become even less meaningful and less helpful in assessing the relationship between compensation and performance consistent with the Center's proposed "pay for performance at a glance" proposal (see above), the current approach to displaying the total salary, regardless of form, facilitates shareholder comparison total pay realized in a given year with the performance that generated it. Understanding the total salary number from the Summary Compensation Table is also important in understanding the amount of risk in the overall compensation plan and whether the plan pays for performance. The format makes it easy to determine whether senior executive compensation plans are over weighted in salary and thus too conservative or place too much compensation in annual incentives, which could be more risky. This approach would also help determine the true salary paid by TARP companies to executives, recognizing that the American Recovery and Reinvestment Act and corresponding regulations permit and even encourage salary to be taken in other forms. For those companies, the current approach would allow users of financial statements to discern which amounts consisted of salary and which consisted of restricted stock grants.

For plans that allow executives to take salary in other forms, the election can be footnoted so that shareholders understand that the amount was not taken in cash. Requiring the amount to be shown as equity or other forms would require that shareholders and stakeholders to sift through footnotes and recalculate salary amounts to determine which form of compensation was salary.

IV. The Commission's Proposal on Compensation Consultant Disclosure and Independence Should Be Implemented With Practical Considerations in Mind

The Commission has proposed disclosure requirements for board compensation consultants whose company or affiliates also provide substantial nonexecutive compensation consulting services to the company. Most Center Subscribers have independent Board compensation consultants, and the Center supports greater disclosure in order to dispel any concerns, real or perceived, about the Board's decisionmaking on compensation. However, the Center urges the Commission to interpret its final release practically to protect against conflicts of interest, while enabling Boards to obtain the information they need to make sound compensation decisions.

The Commission's proposed regulations would cover any consultant or firm that "played a role in determining or recommending the amount or form of executive compensation." This broadly worded provision is likely to also cover consulting firms that provide data to compensation committees to get a sense of the market for talent or to engage in peer group benchmarking. Because most large companies have a relationship with many of the "full service" consulting firms for services other than executive compensation, acquiring data from a consulting firm would trigger the disclosure requirements under the proposal.

The Center believes that when the information provided is limited to survey data that the proposed disclosures should not apply. In many cases, data for a certain position is only available from a given firm, and in providing the data, there is no consultation or other advice given to the Compensation Committee regarding what to pay. The Commission's goals of transparency and avoidance of conflicts of interest would continue to be served, and such an approach would minimize the administrative difficulties from having to disclose information that is not material to an investor's understanding.

Another concern raised by our Subscribers over the short-term is the potential for fee ratcheting as companies stop using full service firms and seek out boutiques. The Center has no doubt that over time the market will stabilize, but in the first few years after it takes effect, there could be shortages of consultants qualified and who have the capacity to do independent Board work. We encourage the Commission to consider a phase-in of the requirement to allow the market to adjust to the new requirements.

V. Director Qualifications and Related Disclosures

Although the issue of director qualifications is beyond the purview of the Center, we would like to offer the following brief comments since expanded disclosure requirements on director qualifications will likely shape the composition of boards, in turn impacting the selection of members to the compensation committee.

In requiring expanded disclosure of board qualifications for all publically traded companies, the SEC should refrain from implementing a "qualifications" checklist for particular committees that may reverse positive trends in board diversity and possibly shrink the pool of potential qualified board nominees. A knowledgeable, engaged and diverse board of directors serves the best interest of the corporation and shareholders. Individual directors should possess the skills and attributes necessary to understand the issues before the board. The most valuable and effective directors, according to the Center's Subscribers, are those that have a broad background and the capacity to quickly acquire information versus those that have a specific subject matter expertise. The Commission's disclosure requirements should give shareholders sufficient information to determine whether directors *as a group* have the skills necessary to manage the company in the best interests of shareholders.

The Center believes that boards should be committed to the pursuit of ongoing education, starting with an orientation process that prepares and educates new board members on issues relevant to their service. The Center also believes that a combination of a sound orientation process for service on particular committees, combined with continuing education targeted to the latest issues and trends, such as on corporate governance and compensation is essential to staying prepared. Efforts to stay current on emerging trends in corporate governance provide for a well-informed board that will better serve the interests of the shareholders that they represent.

With respect to the Commission's proposed disclosure of the company's governance structure, the Center believes that the Board of Directors is in the best position to evaluate whether the roles of CEO and Chairman should be held by the same individual or split. The Commission's proposed disclosure appears to urge that the roles be separated. The Center believes that the Board should consider whether the company's governance structure as a whole, including whether there is a lead independent director, is in the best interests of all shareholders.

VI. Other Requests for Comment

The Commission has requested comment on a number of issues related to disclosure in anticipation of future proposed changes. In addition to the Center's proposal for revising disclosure, as discussed above and in Appendix II, we offer the following comments on those issues.

A. Disclosure of Compensation Paid to Each Executive Officer

The Center disagrees with disclosing compensation paid to each executive office in the proxy. The CD&A and compensation tables for large companies currently run 30 to 50 pages. Adding a substantial amount of new data would not improve disclosure as much as add to the clutter. More importantly, such disclosure would not be material to investors' understanding of the company's pay plan, and the administrative difficulty of compliance would far outweigh investor benefits. Disclosure of all executive officers would also allow competitors to recruit away top talent, thus depleting bench strength and undermining succession planning efforts.

B. Mandatory Disclosure of Performance Targets Regardless of Competitive Harm Implications Should Be Avoided

The Center continues to believe that mandatory disclosure of performance targets is a bad public policy approach, even if disclosure took place three years after performance. Mandatory disclosure would cause companies to further homogenize performance targets, rather than seek company specific measures geared to long-term company, business unit and individual performance. This approach would also encourage companies to potentially convert metric-based compensation plans to purely discretionary plans.

Conclusion

Thank you for the opportunity to comment on this important proposal. We look forward to working with the Commission and the Staff toward a more pragmatic and practical final rule. If you have any questions or would like to discuss this with us further, please contact Tim Bartl of the Center at 202-798-8692 or tbartl@execcomp.org.

Sincerely,

/s/

Charles G. Tharp
Executive Vice President for Policy

Appendix I

Compensation Committee Checklist for Assessing Incentives and Risk

As Board Compensation Committees consider and finalize executive compensation arrangements for 2009, they will seek to confirm that the company's incentive programs are appropriately structured for the company and discourage executives from taking "excessive risk." Many Committees will also voluntarily disclose how their compensation programs address the subject of risk. The Center On Executive Compensation, a research and advocacy organization that provides a principles-based perspective on executive compensation matters, has created the following checklist to help guide Compensation Committees on these issues. The questions that form the basis of the checklist are provided below and in greater detail on the subsequent pages.

1. **Do the performance criteria and corresponding objectives represent a balance of performance and the quality and sustainability of such performance?**
2. **Is the mix of compensation overly weighted toward annual incentive awards or is there a balance of annual and long-term incentive opportunities?**
3. **When compared to a carefully chosen peer group, is the relationship between performance and incentive plan payouts within the range of competitive practices?**
4. **Is there a relationship between performance criteria and payouts under the annual incentive award consistent with targeted performance under the long-term incentive awards?**
5. **Are the long-term incentive performance measures or equity devices overly leveraged and thereby potentially encourage excessively risky behavior?**
6. **Is there a requirement that a meaningful portion of the shares received from incentive award payouts be retained by the participants?**
7. **Has the Board of Directors adopted a recoupment policy which provides for the clawback of incentive payouts that are based on performance results that are subsequently revised or restated and would have produced lower payouts from incentive plans?**
8. **Does the Compensation Committee discuss the concept of risk when establishing incentive performance criteria and approving incentive payouts? Are such discussions recorded in the minutes of the Committee meeting? Does the Compensation Discussion and Analysis articulate how the company's incentive plans mitigate risk?**

Role of the Compensation Committee in Assessing Excessive Risk

The Center On Executive Compensation believes that the Compensation Committee is in the best position to assess the appropriate relationship between the risk inherent in compensation arrangements and how that level of risk corresponds to the overall business strategy and competitive environment of the company. The Compensation Committee is responsible for establishing company-specific performance goals and potential incentive payouts that will motivate and reward performance supporting the long-term success of the company. The following checklist is offered to aid Compensation Committees in assessing the extent to which the design and administration of executive compensation encourages or reinforces excessive risk-taking by management.

1. **Do the performance criteria and corresponding objectives represent a balance of performance and the quality of such performance?**
    - The committee should evaluate whether performance criteria under annual and long-term incentive plans include measures of performance (such as financial or managerial goals) and measures of the quality of that performance (such as return measures or measures of sustainability of performance).
        - For example, incentive plans may focus on performance such as revenue, market share or other growth measures, and profitability, return on invested capital, or other measures of efficiency and return.
    - This dual approach mitigates the potential that executives will aim to achieve increases in measures such as sales or growth while not focusing on the ultimate value creation or sustainability of such performance.

2. **Is the mix of compensation overly weighted toward annual incentive awards or is there a balance of annual and long-term incentive opportunities?**
    - Does the annual incentive make up more than 50 percent of the total compensation opportunity?
        - To avoid placing too much focus on achieving short-term results, the annual incentive should not comprise a disproportionate share of the total annual executive compensation opportunity (base salary, annual incentive, estimated value of long-term incentive).
            - Too much emphasis on short-term results may jeopardize long-term performance

2. Is the mix of compensation overly weighted toward annual incentive awards or is there a balance of annual and long-term incentive opportunities? (Continued)

  - Recognizing that each company will be slightly different, the median division among the elements of compensation for Fortune 500 companies are
    - Salary ≈ 15-20 percent
    - Annual Incentive ≈ 15-20 percent
    - Long-Term Incentive ≈ 60-70 percent
  - Annual incentive in excess of 50 percent of annual compensation opportunity should trigger additional Compensation Committee scrutiny and potentially re-allocation of the annual pay opportunity to other components of the pay package.

- Does the annual incentive plan have unlimited payout potential?
  - The annual incentive plan should limit total payouts and the range of payouts should be set at a reasonable level, as determined by the Compensation Committee, to avoid encouraging decisions that maximize short-term earnings opportunities (swinging for the fences) at the expense of long-term viability.
- Do the annual incentive plan criteria and administration mitigate excessive risk?
  - It may be advisable to provide the Compensation Committee discretion in the incentive plan to adjust above-target payouts downward in the face of excessively risky behavior and discuss why this discretion was exercised in the proxy statement.

3. When compared to a carefully chosen peer group, is the relationship between performance and incentive plan payouts within the range of competitive practices?

- The range of performance, and corresponding payouts, should be within a realistic range of results as compared to the performance of the company's peer group.

4. Is there a relationship between performance criteria and payouts under the annual incentive award consistent with targeted performance under the long-term incentive awards?

- While the annual and long-term incentive plans play different roles in the compensation plan, it is important that annual and long-term incentive plan objectives, metrics and targets are aligned to ensure that both types of awards encourage consistent behaviors and sustainable performance results.

5. Do the long-term incentive performance measures or equity devices potentially encourage excessively risky behavior?

- Do the long-term incentive performance measures require excessively risky behavior to realize target or above target payouts? (e.g., do the targets require performance at so high a level that executives would take improper risks to achieve them?)
- Do the performance criteria and vesting periods of long-term incentive awards overlap and thereby reduce the incentive to maximize performance in any one period?
  - With overlapping awards, an attempt to increase short-term performance may jeopardize company performance in future years and thus payouts under other outstanding awards.
- Does the mix of long-term incentive awards meet the Committee's pay for performance objectives?
  - The Compensation Committee should determine the specific mix of long-term incentive awards that serve the best interests of the shareholders and the company, and may include:
    - performance-vested performance shares or units (which reward the attainment of key financial objectives)
    - time-vested or performance-vested restricted stock or restricted stock units (which may aid in the retention of key talent)
    - stock options or stock appreciation rights (which provide value only if share price appreciates thereby producing direct gains to shareholders).

6. Is there a requirement that a meaningful portion of the shares received from incentive award payouts be retained by the participants?

- Require meaningful stock ownership requirements to link executives' interests to shareholders' interests

- In the Compensation Committee's discretion, require executives to hold a percentage of net equity received as a continuing link between shareholder and management interests.

- The level of share ownership should build over the executive's career
  - As the executive approaches a targeted retirement date the compensation committee may determine it advisable to approve a phased-diversification plan.
  - If the Compensation Committee determines appropriate, ownership may be also be required for some period after retirement
    - consistent with Internal Revenue Code Section 409A, which requires "key executives" to delay payout of deferred compensation for six months' after departure.
  - Holding requirements should not be so great as to potentially encourage overly conservative management decisions that would harm shareholder value.

7. Has the Board of Directors adopted a recoupment policy which provides for the clawback of incentive payouts that are based on performance results that are subsequently revised or restated and would have produced lower payouts from incentive plans?

- Adopt a strong clawback provision to provide for recoupment in the event of a material restatement.

- The Compensation Committee, in its discretion, should determine when the need for a clawback is triggered, to whom the clawback should apply and the mechanism for recouping incentive payments.

8. **Does the Committee discuss the concept of risk when establishing incentive performance criteria and approving incentive payouts? Are such discussions recorded in the minutes of a Committee meeting? Does the Compensation Discussion and Analysis articulate how the company's incentive plans mitigate risk?**

   - In addition to competitiveness and the linkage of pay and business strategy, the relationship between business risk and incentive compensation should be a key consideration in setting performance criteria, the corresponding mix of awards and the range of incentive plan opportunities.

   - The Compensation Committee should meet with the company's principal financial officer and/or corporate risk officer prior to approving financial incentive criteria and meet with him/her periodically to facilitate a complete understanding of how the company's financial performance interacts with its strategy and compensation programs.

   - Company proxy disclosures should briefly explain how incentive designs mitigate risk to help demonstrate how risk is considered and addressed by the Committee in approving incentive plans.

Appendix II - Table 1: 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	2006-08	$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 2005 and 2008. 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

Appendix II - Table 2: 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.

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