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SEC Staff Issues Comment Letters on Executive Compensation Disclosures

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Background

The staff of the Division of Corporation Finance of the Securities and Exchange Commission (the “staff”) has performed a comprehensive review of the first filings that include the revised executive and director compensation disclosures.¹ The press² has referred to 300 or so comment letters from the staff, faxed directly to the chief executive officers of the registrants beginning in late August, asking for more detail and clarification regarding these compensation disclosures. What were the objectives of the review? To ensure that future filings comply with the new rules and to enhance the disclosures.

The staff has provided some helpful guidance on executive compensation disclosures. First, the staff recently updated the [Questions and Answers](#) on Regulation S-K, Item 402, “Executive Compensation.” Second, John White, director of the Division of Corporation Finance, gave a recent [speech](#) addressing some hot disclosure-related topics. In addition, at the July 10, 2007, SEC Regulations Committee Meeting (see Deloitte & Touche LLP’s [August 3, 2007, Heads Up](#)), the staff noted that “although registrants have generally been doing a good job in adhering to the new rules, there have been a number of recurring observations that have been noted in comment letters.”

If your company has already received a letter, see below for more details about response deadlines and other considerations. Don’t breathe a sigh of relief just yet if your company hasn’t received a comment letter — more letters may be forthcoming. Also, be on the lookout for an anticipated report from the staff that will summarize the findings of the review process.

Common Issues Raised in Letters

The comment letters cover various disclosure-related topics. Since the content of the disclosures is primarily a legal determination, companies should consult with legal counsel in preparing their responses. While each letter pertains to the registrant’s specific facts and circumstances, the letters include comments on recurring themes.

¹ In July 2006, the SEC adopted amendments to its disclosure requirements for executive and director compensation and other matters (Regulation S-K, Item 402, “Executive Compensation”). The purpose of the amendments was to give investors increased transparency regarding the compensation practices of SEC registrants, particularly the most highly paid executives. The rules were effective for Forms 8-K issued on or after November 7, 2006; for Forms 10-K and 10-KSB for fiscal years ending on or after December 15, 2006; and in initial registration and proxy/information statements filed on or after December 15, 2006. See Deloitte & Touche LLP’s [August 21, 2006, Heads Up](#) for additional information.

² “S.E.C. Queries Companies on Executive Pay,” *New York Times*, September 1, 2007.

One of the recurring comments in the letters that is raising concern with registrants is a request for analysis of why omission of performance targets or other information is appropriate. The executive compensation disclosure requirements allow companies to exclude performance targets and other factors or criteria involving confidential information if the disclosure of such information would result in competitive harm. While companies are not required to formally request confidential treatment to omit these disclosures, they must meet the confidential treatment standard and demonstrate to the staff upon request that they have done so. When determining whether to omit such disclosure, companies should consider Instruction 4 to Item 402(b) of Regulation S-K and other relevant guidance,³ and consult with their legal counsel. Even if omission of targets or other factors or criteria is appropriate, registrants must disclose “how difficult it will be for the executive or how likely it will be for the registrant to achieve the undisclosed target levels or other factors.”

Summarized examples of other frequent comments by the staff include the following:

One of the recurring comments in the letters that is raising concern with registrants is a request for analysis of why omission of performance targets or other information is appropriate.

Topic	Sample Requests From SEC Staff
Performance Targets	<ul style="list-style-type: none"> • Provide quantitative disclosure of all terms of the targets that need to be achieved for the named executive officer to earn performance-based awards. • Clarify situations in which the compensation committee can choose from a variety of performance goals or adjust goals throughout the year. • See also the discussion on performance targets in the paragraph above.
Change of Control	<ul style="list-style-type: none"> • Describe payment and benefit levels for termination and severance packages and how they were determined. • Discuss specific circumstances that would trigger change-of-control payments. • Revise this disclosure to be more understandable.
Compensation Discussion and Analysis (CD&A)	<ul style="list-style-type: none"> • Give reasons for differences among the amounts of compensation awarded to the named executive officers. • Provide an analysis of how you arrived at, and why you paid, each level and form of compensation. • Discuss to what extent discretion can be used to adjust an award.
Director Independence and Compensation	<ul style="list-style-type: none"> • Provide detail on relationships and arrangements considered in determining director independence. • Disclose the assumptions used to value director stock awards. • Describe the processes used to determine director compensation.
Elements of Compensation	<ul style="list-style-type: none"> • Explain the procedures used to determine the appropriateness of each element of compensation. • Discuss how each element of compensation is affected by individual performance. • Describe how the compensation committee determines the base salary level for each named executive officer.

³ Including Question 3.04 in the staff's [Questions and Answers](#) on Item 402 of Regulation S-K.

The staff will make the comment letters and responses available to the public no sooner than 45 days after completion of the comment process.

Topic	Sample Requests From SEC Staff
Compensation Committee	<ul style="list-style-type: none"> • Ensure that the disclosure discusses the role of the CEO and other members of management in determining compensation. • Identify the titles and roles of management members who work with the compensation committee and compensation consultants. • Clarify the role of the CEO in determining his or her own compensation.
Compensation Consultants	<ul style="list-style-type: none"> • Discuss the nature of assignments and instructions given to the compensation consultants. • Provide the name of the independent compensation consultant engaged by the company. • Describe the interactions between the compensation consultants and the compensation committee.
Benchmarking Compensation	<ul style="list-style-type: none"> • Identify the companies used in the benchmarking process. • Disclose how actual payments compared with targeted parameters and the reasons for the difference. • Disclose which elements of compensation are materially affected by the benchmarking process.
Certain Relationships and Related-Party Transactions	<ul style="list-style-type: none"> • Disclose whether the company has specific procedures to approve transactions with related parties (and others under Section 404(a) of Regulation S-K). • Disclose policies for related-person transactions. • Discuss credit relationships between the company and its officers and directors.

Next Steps

Timing

The staff is generally allowing 30 days for responses to the executive compensation disclosure inquiries. Also, the staff generally is asking registrants to provide required information to the staff and to incorporate additional disclosures in future filings. However, since executive compensation information is incorporated into Form 10-K, amendment of previously filed information is a possibility. Registrants may need to respond to more than one round of staff comments to determine the extent to which additional disclosures are required. The staff will make the comment letters and responses available to the public no sooner than 45 days after completion of the comment process.

Deloitte & Touche Professionals

Deloitte & Touche professionals are also reminded of the requirement of AAPMS GEN 630 to submit all SEC comment letters for attest clients to National Office — SEC Services. Please contact Jeanne Riggs, Partner — SEC Services, (202) 370-2212, if your client has received one of these letters or for further details about the comments being issued by the SEC staff.

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