



## ***SEC Proxy Disclosure***

### ***Compensation Committee Relationships***

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## ***New SEC Proxy Disclosure Rules***

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Proposed new pay disclosure rules announced by SEC on January 17:

- For implementation beginning with the 2007 proxy statement.
- First major change since 1992.
- New rules driven by:
  - Drive to provide better and more complete information for investors.
  - Desire to get to “one number” for pay for senior executives.
  - Better disclosure of “hidden” pay – deferred compensation, SERPs, perquisites etc.

Key outcomes include:

- Compensation Discussion & Analysis (CD&A) report to replace Compensation Committee report and Performance Graph.
- New Summary Pay Table with a total pay figure for each executive.
- Supporting tables for:
  - Equity incentives.
  - Deferred compensation arrangements.
  - All other compensation, including perquisites.
  - Outside director pay.

## Compensation Discussion & Analysis

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- Replaces the Compensation Committee Report and Performance Graph.
- CD&A will be a “filed” report vs. “furnished” status of the Committee Report:
  - Committee Report was made a furnished report to encourage openness.
  - SEC believes that openness did not occur.
  - “Filed” = subject to Sarbox signing requirements for CEO and CFO.
- Performance Graph information now readily available through Internet.
- The CD&A should be inclusive and in “plain English” – no boilerplate.

**Comment: Client position on Performance Graph has been an important advance notice of “mood” of Compensation Committee.**

## Compensation Discussion & Analysis

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Key questions to be answered in CD&A:

- What are the objectives of the company's compensation program?
- What is the compensation program designed to reward and not reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and, where applicable, the formula) for each element?
- How does each element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements?

CD&A is intended to be:

- “Principles-based” – it should identify the disclosure concept and provide illustrative examples.
- Comprehensive – include discussion of both in-service and post-termination compensation.

## ***Compensation Tables***

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Three categories of compensation tables are proposed:

- Current compensation for the last year and two previous years:
  - Summary Compensation Table.
  - Two supporting tables related to equity/LT incentives.
- Holdings of equity-based interests that are potential sources of future earnings and realizations of those interests, including:
  - Option exercise gains.
  - Restricted stock vesting.
- Retirement and other post-employment compensation:
  - Retirement plans, both qualified and non-qualified.
  - Deferred compensation arrangements.
  - Potential severance and change-in-control outcomes.

All tables should include narrative disclosure to enhance investor understanding.

## Summary Compensation Table

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- Key outcome is a total pay figure for each named executive, requiring the following changes:
  - An option value number, driven by FAS 123R calculation.
  - A new “Other Compensation” column combining two current columns.
  - Significant increase in items included in new “All Other Compensation” column.
  - Addition of a total compensation column:
    - Adds up all the other columns.
    - Determines the executives to be included in the proxy statement.
- Executives to be included:
  - Principal Executive Officer (PEO).
  - Principal Financial Officer (PFO).
  - Next three highest paid executive officers.
  - Up to three more employees with higher pay than one of the five named officers.

## “All Other Compensation” Column

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- Includes all compensation not reported in other columns, including:
  - Earnings on deferred compensation.
  - Increase in pension value.
  - Perquisites and other personal benefits:
    - New reporting threshold of \$10,000 vs. old \$50,000
    - Footnote disclosure required of individual perquisites.
  - Severance/change-in-control amounts.
  - Company contributions to DC plans.
  - Life insurance premiums.
  - Tax gross-up amounts.
  - Securities purchased at a discount.

Possibility of a supplemental table supporting “All Other Compensation” column.

## Supplemental Annual Compensation Tables

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- Two tables that provide information on equity/long-term incentive plans.
- Includes other important information about equity/LT grants, including:
  - Number of options/units/shares.
  - Grant date.
  - Exercise price.
  - Vesting/expiration dates.

## Narrative Disclosures

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- All tables should include additional narrative disclosures:
  - Provide additional information not included in tables.
  - Provide context.
  - In English, not boilerplate.
- Option repricing information, meaning the elimination of the ten year option repricing table.
- Descriptions of:
  - Incentive plan performance measures (e.g., EPS).
  - But not performance targets (e.g., target EPS = \$3.26).
- Waivers or modifications to incentive plan terms.

## Holdings/Exercises/Vestings of Previously Awarded Equity

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- Two tables are proposed:
  - Outstanding Equity Awards at Fiscal Year End.
  - Option Exercises and Stock Vesting.
- Outstanding Equity Table
  - In the money value of options.
  - Current value of restricted stock/units.
  - Current value of performance shares, etc.
- Option Exercises and Stock Vesting Table
  - Number of shares acquired.
  - Value realized.
  - Grant date fair value reported in Summary Compensation Table.

**Note: These tables are one table in current proxy statements, with a couple of extra columns.**

## Post Employment Compensation

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- Key issue: Retirement and other post-termination compensation has grown over the years.
- Such compensation represents a “significant commitment” of corporate resources and a “significant portion” of overall compensation.
- Proposed: Retirement Plan Potential Annual Payments and Benefits Table
  - Replace current pension table.
  - Provide annual retirement benefit at normal and early retirement dates.
- Proposed: Nonqualified Defined Contribution and Other Deferred Compensation Plans Table
  - Includes changes to deferred compensation plans in a year.
  - Totals to an aggregate balance at year end.
  - Links back to Summary Compensation Table.

## Director Compensation

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- New Director Compensation Table
- Replaces current narrative disclosure.
- Breaks out each director separately.
- Includes a total column similar to Summary Compensation Table.
  
- **Comment: Seems like overkill for an issue not currently identified as an issue, although director pay has increased significantly over the past two-three years.**

## New SEC Proxy Disclosure Rules

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### What Should A Compensation Committee Be Thinking About?

Consider some changes for the **2006** proxy statement:

- Rewrite the Compensation Committee Report in the form of the CD&A.
- Consider changes to the Summary Compensation Table, including:
  - Report FAS 123R grant date value of options/SARs in the Summary Compensation Table.
  - Add a “total” column to the Summary Compensation Table.
  - Include the CFO in the Summary Compensation Table.
- Disclose more information on perquisites.
- Create a Summary Compensation Table for non-employee Directors.

## New SEC Proxy Disclosure Rules

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### What Should A Compensation Committee Be Thinking About?

Consider some tasks to undertake **this year**, for implementation for the **2007** proxy statement:

- Mock up the CD&A to determine possible program changes and data needs:
  - Strengthen Board and Committee processes to ensure “best practices”, preserve business judgment protection and provide input to CD&A.
  - Ensure CEO, CFO and Board understand that CD&A is a “filed” report and will be covered under Sarbox certification requirements.
  - Integrate data collection systems with the new disclosure needs and work to fill any data gaps.
- Monitor one-time compensation transactions - think about the impact of relocation, retention awards, SERP programs and deferred compensation arrangements – outcome determines named executives.
- Evaluate deferred compensation plans for high yield interest crediting and other factors.
- Review CIC and severance arrangements in context of new reporting requirements.
- Review details of FAS 123R expense.

Timing for the above activities could be upon release of final regulations by the SEC – 9/30?.