CD&A Debut: A Reality Check

Thoughtful disclosure is required for performance targets, clawback provisions, and perquisites.

By Laraine Rothenberg and Mindy Meyers

Now that the 2007 proxy season is coming to an end, it's time to look back and review the importance of the new Compensation Discussion and Analysis (CD&A) section of a company's proxy statement. The CD&A includes the rationale for providing specific compensation, as well as detailed disclosure of certain executive compensation practices. Three items—performance targets, clawback provisions, and perquisites—are getting attention as significant policies that require thoughtful disclosure.

■ Performance Targets. Under the new CD&A rules, a company generally must provide information on performance measures and target goals related to incentive compensation. They aren't required to disclose specific quantitative or qualitative targets if doing so would result in competitive harm to the company, which is the same standard used for confidential treatment request under the Freedom of Information Act.

It's not necessary to request confidential treatment, although the Securities and Exchange Commission reserves the right to ask the company to demonstrate that it's deserved. However, even if no targets are disclosed, the company still must discuss the difficulty of obtaining the goals and/or the likelihood of achievement.

In this initial round of the new CD&A, many companies did not address specific target levels. The clarity of the alternate discussion also varied widely. Many companies only provided levels achieved in prior years, while others kept the entire discussion vague, with language describing goals to be "achievable" or "sufficiently challenging."

■ Clawbacks. The CD&A rules make clear that a clawback policy must be disclosed. They require companies to discuss policies or decisions that involve a change to or the recovery of any payments to executives. In addition, the Sarbanes-Oxley Act of 2002 requires the CEO and the CFO to forfeit certain bonuses and profits, and reimburse the company if the executive engaged in misconduct that caused or partially caused a restatement of financial results.

This new discussion comes as numerous shareholder proposals have called for companies to institute or strengthen a clawback policy. Therefore, many companies have or are adopting policies disclosable in the CD&A.

It became clear in this proxy season that clawback policies are becoming more prevalent and sometimes are even broader than is required under SOX. For example, some policies apply to all executive officers rather than just to the CEO and CFO. One company's policy allows it to seek reimbursement for incentive awards "if accounting restatements occur within three years after payment," regardless of any finding of wrongdoing. In addition to the possible forfeiture of awards, this policy specifically allows the compensation committee also to "rescind vesting, or the acceleration of vesting, of an award."

■ Perquisites. The CD&A is where companies can provide the back story for expenditures such as airplane and vehicle use, country club dues, home office allowances, life insurance, and tax gross-ups. Many perks are considered important to "attract and retain" key employees.

The justifications vary only slightly among companies. Airplane use is often explained as serving to fulfill security measures and provide increased efficiency. Country club memberships are considered competitive compensation, justified for client entertainment purposes, and to "facilitate the CEO's role as a company representative in the community."

The new CD&A functions in many respects as a policy forum, offering a reality check to shareholders concerning the company's stance on certain compensation trends and common policies.

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