Executive Compensation In a New Age of Disclosure

Congress and the SEC turn up the heat on how incentives to keep executives on board affect the company bottom line and even the U.S. economy

23

Daniel J. Macy

A staggering 87 percent of corporate executives told an executive recruiting firm in 2006 that they were planning to leave their company within the next six months.

"Eroding corporate loyalty and a very tight job market are a dangerous duo for Corporate America," says Dave Opton, CEO and Founder of ExecuNet, the firm that conducted the study. "Given the quality and quantity of new job opportunities being created every day, companies need to take a long and hard look at why their key leaders may be looking to jump ship."

What do corporate boards do to attract and retain these professionals who are in great demand? Of necessity, they turn to competitive pay and benefits – but is this spurring better performance or just encouraging greed?

Enron and its Progeny

Since the spectacular collapse of Enron, the company that became emblematic of flaws in the way companies motivate and reward their executives, the Securities and Exchange Commission (SEC) has enacted regulations to make corporate accounting more transparent. Congress responded with the Sarbanes-Oxley Act, a law that became practically synonymous with the Enron fiasco and which created legions of auditors that companies had to hire to comply with the new law's tough disclosure requirements. Detractors have criticized virtually every aspect of that law, and at worst have said it is responsible for companies deciding to trade stock on other countries' exchanges, eschewing the onerous burdens on companies listed on American stock exchanges. Whether that is accurate or not, no one can deny that the early part of the century opened a new chapter on corporate disclosure. It appears the debate in corporate America has moved on to executive compensation – the very way the compensation committees and boards of directors motivate their top executives to make their companies perform financially.

Daniel J. Macy is editor of Thompson Publishing Group's Employer's Guide to Fringe Benefit Rules and Employer's Handbook: Complying with IRS Employee Benefits Rules.

The Crux of the Problem: Alignment of Incentives

The debate on executive pay has turned on whether company boards are rewarding executives for performance or creating incentives for avarice. Enough regulators, lawmakers and investors seem to believe the latter that the SEC has promulgated new regulations and Congress has toyed with many proposals, including so-called “say on pay” legislation (see page 233), and has opened an investigation into compensation decision-making practices.

Executive pay is no minor issue; in the view of these lawmakers and regulators, the men and women who lead publicly traded corporations are running the national economy. Thus, their incentives should be aligned with the interests of not only their companies, but by extension, with nothing less than the U.S. economy. At least, that was the tone of Congress throughout the 2007 House Committee on Oversight and Government Reform hearings (see Congressional Response on page 233).

The relationship between executive compensation and the national economy – or, more accurately, Congress’, investors’ and the public’s perception of the relationship – means that scrutiny of executive pay is not going to diminish any time soon. Congress even blames the recent meltdown of the mortgage market on poorly conceived executive incentives. Public companies will have to learn to deal with disclosure requirements as they evolve.

‘Pervasive’ Compensation Practices

“Perhaps most insidious of all in discouraging discipline [have] been pervasive compensation practices,” said Paul Volcker, the Federal Reserve chairman under Presidents Jimmy Carter and Ronald Reagan (from 1979 to 1987) in remarks to the New York Economic Club in April 2008. “In the name of properly aligning incentives, there are enormous rewards for successful trades and deals and for loan originators. The mantra of aligning incentives seems to be lost in the failure to impose symmetrical losses – or frequently any loss at all – when failures ensue. The point has been made time and again, yet, with rare exceptions, compensation committees and their consultant acolytes seem unable to break the pattern. That may not be an area that law or regulation can, or should, deal with effectively. Surely it is a matter for the leadership of large institutions, particularly those sheltered by official support.”

The SEC’s Response

The SEC set the stage for higher executive pay disclosure standards in July 2006, when it voted to “adopt revisions to our rules governing disclosure of executive compensation. We intend these revisions to provide investors with a clearer and more complete picture of compensation to principal executive officers, principal financial officers, the other highest paid executive officers and directors.” The new proposed rules required companies to print tables: (1) showing stock option grants in the proxy reports they file with SEC; and (2) in their annual proxy statements showing stock option grants made to named executive officers.

By December 2006, the SEC had issued interim final regulations that revised the tabular stock option disclosure rules, allowing companies to report stock option grants over a longer period. (For the text of the rules, see 71 *Fed. Reg.* 78338-01, or go to http://www.sec.gov/rules/final/2006/33-8765.pdf.)

 ©Thompson Publishing Group

In January 2007, the SEC amended the rules to align the reporting of equity awards in the Summary Compensation Table and the Director Compensation Table to the amounts disclosed in the financial statements under Federal Accounting Standard (FAS) 123R. This standard requires recognition of the costs of equity awards over the period in which an employee is required to provide service in exchange for the award. Using this approach in executive compensation disclosure will give investors a better idea of the compensation an executive earned during a particular reporting period, said SEC Chairman Christopher Cox (see box).

The January 2007 SEC Amendment

Under this amendment to the tabular stock option disclosure rules:

- The dollar values required to be reported in the Stock Awards and Option Awards columns of the Summary Compensation Table and the Director Compensation Table are revised to disclose the compensation cost of those awards, before reflecting forfeitures, over the requisite service period, as described in FAS 123R. Forfeitures must be described in accompanying footnotes.
- The Grants of Plan-Based Awards Table is revised to require disclosure of the grant date fair value of each individual equity award, computed in accordance with FAS 123R; the Director Compensation Table that Item 402 of Regulation S-K requires is revised to make footnote disclosure of the same information mandatory.
- The Grants of Plan-Based Awards Table is revised to require disclosure of any option or stock appreciation right that was repriced or otherwise materially modified during the last completed fiscal year, including the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R. The Director Compensation Table that Item 402 of Regulation S-K requires is revised to make footnote disclosure of the same incremental fair value information mandatory.

Compliance Dates:

The compliance dates for the interim final rules were the same as those for the amendments to Item 402 of Regulations S-K and S-B adopted on July 26, 2006. Compliance with the Item 402 amendments is mandatory for:

- proxy, information and registration statements filed on or after Dec. 15, 2006 that must include Item 402 disclosure for fiscal years ending on or after Dec. 15, 2006; and
- Forms 10-K and 10-KSB for fiscal years ending on or after Dec. 15, 2006.

Congress Reacts

The interim rules set off a sharp negative response from Congress. House Financial Services Committee Chairman Rep. Barney Frank (D-Mass.) and other critics said the revised treatment of stock option reporting weakened the SEC's earlier proposed rules. Frank chided the SEC for "backtracking."

"Backtracking by the SEC on this important matter of stock options reinforces my determination that Congress must act to deal with the problem of executive compensation that is now unconstrained by anything except the self restraint of top executives, a commodity that is apparently in insufficient supply" said Rep. Frank, who later introduced a "say on pay" bill in Congress (see Congressional Response below).

Cox said of the change, however, it "will be easier for companies to prepare and for investors to understand."

How to Comply With SEC Disclosure Rules

Understanding and complying with what the SEC wanted proved difficult for public companies. That became apparent when they filed their annual Schedule 14-A proxy statements and the SEC sent letters criticizing their attempts.

In August 2007, approximately 350 companies began receiving the letters, which asked for more information about their executive pay programs. Although the details of the letters were not made public, some media outlets described them as "critiquing" the companies' disclosures.

Changes in the SEC disclosure rules under Regulation S-K loomed on the horizon for a while before companies had to comply. The first proxy season yielded unsatisfactory results in the SEC's eyes. In 2006, the SEC had amended longstanding rules under the Securities Exchange Act of 1934 (Exchange Act) to require public companies to disclose details of executive compensation to shareholders. Many companies got a generally poor report card from the SEC on their efforts to detail executive pay in the management discussion and analysis portion of their proxy statements.

Vague Tie-in Between Compensation and Performance

In a speech to the American Bar Association on Aug. 14, 2007, John White, director of the SEC's division of corporation finance, explained that SEC staff had looked through the "first couple of hundred disclosures" of the 2007 proxy season and said there would be some give-and-take of comment letters and company responses. White said the agency was taking a close look at performance targets, one of the areas the new rules require companies to detail in their disclosures. "We're seeing a lot of really vague disclosure in this area about 'individual performance goals and targets' without further discussion," he said.

While this raised questions on whether the SEC further would amend the rules, it opted for a more personal touch. In January 2008, it sent a second wave of letters, this time to about 200 companies.

No Magic Bullet – Writing the Management Discussion & Analysis

The second letters the SEC sent illustrate that the agency found the companies' responses to the revised disclosure regulation lacking after it read their proxy statements. A major reason for the dissatisfaction was how the companies described the link between financial performance and executive compensation in the Management Discussion & Analysis section of their 2007 proxy statements.

In a letter to the chairman of one company, dated Aug. 21, 2007, the SEC wrote:

> In connection with your discussion of the various elements, you provide some description and analysis of how company performance affects compensation practices and levels, but little, if any, discussion of individual performance, even though you note that it was a primary determinate of compensation.

That company said in an Oct. 10, 2007 letter that in future filings it would elaborate on how the named executives' performance against individual financial and operational objectives, and company values, affected their material differences. (See box on next page for the text of the company's management discussion & analysis section of the proxy statement.)

An Example of a Publicly Traded Company's Management Discussion and Analysis of Performance Incentives

[Filed with SEC in 2007]

Annual Incentives – A Named Executive Officer's annual incentive award is based 50% on the company's actual performance against the pre-established non-GAAP diluted earnings per share target as reviewed by the Board of Directors and 50% on individual performance as described in the Performance Management System section. Additionally, a Named Executive Officer's annual incentive award payment is modified based on the extent to which the executive meets pre-established diversity placement goals and demonstrates other actions that promote diversity (e.g., ensuring that diversity candidates are considered for developmental opportunities; including diversity candidates in succession plans; mentoring employees with diverse backgrounds; leading an employee affinity group; and holding staff members accountable for advancing our diversity objectives). We place an emphasis on diversity in our annual incentive program because we believe a diverse workforce, which engenders diversity of thought and perspective, is a source for creating a competitive advantage.

We believe this approach for determining incentive award payments balances the need to consider overall company performance, individual results specific to an executive's functional area of responsibility, and the individual's ability to achieve results while also demonstrating the Core [*XYZ CORP.*] Behaviors. The recommended payments are reviewed and approved by the Committee in March of the year following the performance year with the awards paid by March 15th.

In March of 2007, the Committee approved a 2007 threshold level of performance for non-GAAP diluted earnings per share of $1.00. This threshold level of performance represented 80% of our 2007 target of $1.25. Achievement below the $1.00 threshold would result in no bonus payments.

SEC 2007 Guidelines

In January 2007, the SEC issued guidelines on the disclosure rules amendment it published in December 2006, and updated the guidance in August 2007 with a lengthy set of questions and answers (see box on page 232 for excerpt). Section 3 of the Q&A deals with executive compensation. The rules governing what to include in the summary compensation table have also given rise to problems for companies. Section 4 of the Q&A covers what to include.

The information required to be reported in the "Summary Compensation Table" is quite specific. Here is a sampling:

- If a person that was not a named executive officer in fiscal years 1 and 2 became a named executive officer in fiscal year 3, the compensation information for him or her must be disclosed in the Summary Compensation Table for that person only for fiscal year 3.
- A discretionary cash bonus that was not based on any performance criteria be reported in the Bonus column (column (d)) of the Summary Compensation Table rather than in the Non-equity Incentive Plan Compensation column (column (g)), In order to be reported in the Non-equity Incentive Plan Compensation column (column (g)) , the bonus would have to be pursuant to a plan providing for compensation intended to serve as incentive for performance to occur over a specified period that does not fall within the scope of FAS 123R.
- Companies are to include in the Salary column (column (c)) or the Bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based, or other forms of non-cash compensation have been received instead by the named executive officer. In a situation

Excerpt: August 2007 Q&A Guidance From the SEC

Section 3. Item 402(b) – Compensation Discussion and Analysis

Question 3.01

Question: Is the guidance regarding compensation discussion and analysis disclosure concerning option grants that is provided in Section II.A.2. of Securities Act Release No. 8732A applicable to other forms of equity compensation?

Answer: The same disclosure provisions governing required disclosure about option grants also govern disclosure about restricted stock and other non-option equity awards. This includes the example of potential material information identified in Item 402(b)(2)(iv) of regulation S-K, which indicates that it may be appropriate to discuss how the determination is made as to when awards are granted, including awards of equity-based compensation such as options.

Question 3.02

Question: In presenting compensation discussion and analysis disclosure about prior option grant programs, plans or practices, are companies required to provide disclosures about programs, plans or practices that occurred outside the scope of the information contained in the tables and otherwise disclosed pursuant to item 402 (including periods before and after the information contained in the tables and otherwise disclosed pursuant to item 402)?

Answer: Yes, in certain cases, depending on a company's particular circumstances, disclosure may be required as contemplated by instruction 2 to item 402(b) of regulation S-K.

Question 3.03

Question: Are companies required to include disclosure about programs, plans or practices relating to option grants in the compensation discussion and analysis disclosure for their first fiscal year ending on or after Dec. 15, 2006, or is this disclosure only required for future fiscal periods?

Answer: Companies are required to include disclosure about programs, plans or practices relating to option grants in the compensation discussion and analysis disclosure for fiscal years ending on or after Dec. 15, 2006, as well as any other periods where necessary as contemplated by instruction 2 to item 402(b) of regulation S-K.

Question 3.04

Question: How does a company determine if it may omit disclosure of performance target levels or other factors or criteria under instruction 4 to item 402(b)?

Answer: The new rules clarify that a company should use the same standard for evaluating whether target levels (and other factors or criteria) may be omitted as it would use when making a confidential treatment request under Securities Act Rule 406 or Exchange Act Rule 24b-2; however, no confidential treatment request is required to be submitted in connection with the omission of a performance target level or other factors or criteria. The company must make its determination based on the established standards for what constitutes confidential commercial or financial information, the disclosure of which would cause competitive harm. These standards have largely been addressed in case law. To the extent that a performance target level or other factor or criteria otherwise has been disclosed publicly, a company cannot rely on the instruction to withhold the information. Because compensation discussion and analysis will be subject to staff review, a company may be required to demonstrate that withholding target information meets the confidential treatment standard, and will be required to disclose the information if that standard is not met. A company that relies on the instruction to withhold information must discuss how difficult it will be for the executive or how likely it will be for the company to achieve the undisclosed target level, factor or criteria, which was not required prior to the new rules.

Source: U.S. Securities and Exchange Commission, Aug. 8, 2007.

 ©Thompson Publishing Group

> where the value of the stock, equity-based or other form of non-cash compensation is the same as the amount of salary or bonus foregone at the election for the named executive officer, the amounts should be disclosed in the Salary or Bonus column, as applicable. The result would be different if the amount of salary or bonus foregone at the election of the named executive officer was less than the value of the equity-based compensation received instead of the salary or bonus, or if the agreement pursuant to which the named executive officer had the option to elect settlement in stock or equity-based compensation was within the scope of FAS 123R.

(For the full text of the Q&A go to http://www.sec.gov/divisions/corpfin/guidance/execcomp402interp.htm.)

Congressional Response

Congress has taken a number of actions in response to perceived executive compensation excesses.

'Say on Pay' Legislative Attempts

The campaign to make executive compensation align with various lawmakers' visions was well afoot in March 2007, when Rep. Frank introduced the Shareholder Vote on Executive Compensation Act (H.R. 1257). The bill would have required a nonbinding shareholder vote on executives' pay packages. The measure passed the House on a 269-to-134 floor vote on April 20, 2007, but the Senate had not taken up the bill as this book went to print.

Frank's bill intended to give SEC the authority it said it needed to force a shareholder vote, or perhaps, it was to call the SEC chairman's bluff. Noting that the SEC under Chairman Cox adopted rules that would require companies to publish a chart showing compensation for the top officials in their annual proxy forms, Frank said in a floor statement, "We add one simple fact here. The SEC has said that it does not have the power to go further and compel corporations to allow the owners to vote. Our bill simply does that."

"We are talking about real money," Frank said. "We are talking about money that goes to these top executives that could be used for other purposes."

The measure would require only an advisory vote, Frank acknowledged, "But we do not think boards of directors will likely disregard an advisory opinion from the shareholders and, therefore, we think that this is an important input that the board should have." An identical Senate bill, S. 1181, stalled in the Committee on Banking, Housing and Urban Affairs in 2007.

Investigation of Conflicts of Interest

Unchallenged generosity of corporate compensation committees found another congressional enemy – House Committee on Oversight and Government Reform Chairman Henry Waxman (D-Calif.). On Jan. 31, 2007, Waxman sent a letter to the compensation committee chairs of each of the *Fortune 250* companies, asking them to provide information about how they use compensation consultants (see box on page 234).

In May 2007, Waxman launched an investigation into practices inherent in executive compensation decisions.

Waxman Letter to *Fortune 250* Companies

The letter requested information about:

1) whether the company has used one or more compensation consultants to assist in determining or recommending the compensation for senior executives, and if so, who retained the consultant – the compensation committee itself, or by company management;
2) to whom the consultant reports – to the compensation committee, or to company management;
3) whether the consultant performed other non-compensation related services to the company;
4) whether the company disclosed to its shareholders the role of the consultant in determining or recommending executive compensation, and whether the company disclosed information regarding other services the consultants provided; and
5) whether the company has a written policy regarding whether executive compensation consultants can perform other services for the company unrelated to executive compensation.

Waxman started by querying members of compensation boards at top public companies about their practices. But he promptly shifted the spotlight to consultants after he started to receive responses. On May 8, Waxman announced he had sent letters to six leading executive compensation consulting firms seeking information about the services they provide large U.S. corporations.

The letter demanded that each firm identify each company for which it provided both executive compensation consulting services and other types of services. Then, Waxman wanted to know the nature of the compensation services, the total revenue for those services, and the nature of all other services provided to that company, as well as the revenues those services bring in – for each company.

Not all of the firms gave up the information so easily. The committee ended up having to subpoena at least one of them to get the requested data. The committee's majority staff then issued key findings (see box).

Key Findings From Oversight Committee Majority Report on Executive Compensation

Based on non-public data the committee gathered from consulting firms, the report found that in 2006:

- At least 113 of the *Fortune 250* companies received executive pay advice from consultants that were providing other services to the company.
- The consultants providing both executive compensation advice and other services to *Fortune 250* companies were paid almost 11 times more for providing other services than they were paid for providing executive compensation advice. On average, the companies paid these consultants more than $2.3 million for other services and less than $220,000 for executive compensation advice.
- One *Fortune 250* company paid a compensation consultant more than $11 million for other services in 2006, more than 70 times what the company paid the consultant for executive compensation services.
- More than two-thirds of the *Fortune 250* companies that hired compensation consultants with conflicts of interest did not disclose the conflicts in their SEC filings. In 30 instances, the companies informed shareholders that the compensation consultants were "independent" when in fact they were being paid to provide other services to the company.
- The median CEO salary of the *Fortune 250* companies that hired compensation consultants with the largest conflicts of interest was 67 percent higher than the median CEO salary of the companies that did not use conflicted consultants.

Source: Executive Pay: Conflicts of Interest Among Compensation Consultants, United States House of Representatives Committee on Oversight and Government Reform, Majority Staff (December 2007).

Stock Option Rules Out of Alignment

Sen. Carl Levin (D-Mich.) introduced a bill in 2007 to deal with what he viewed as misalignment of two sets of rules governing stock options because, he said, they "make no sense." His colleague Sen. Norm Coleman (R-Minn.), the ranking member on the Senate Permanent Subcommittee on Investigations, which Levin chaired, joined him in that call, and they held a hearing in June of that year. No legislation has resulted yet, however. Nevertheless, their qualm was instructive. "It is time to take a serious look at whether it makes sense to have two completely different sets of stock option rules for financial accounting and tax purposes," Levin said, "especially when the result is a revenue loss of billions of dollars."

Two sets of rules were in question – one from the tax Code, the other from the Financial Accounting Standards Board (FASB), which the SEC oversees.

On the one hand, FAS 123R – which the FASB issued in 2005 – requires companies to book an expense equal to a stock option's fair value on the date that the company grants the option. An employee who receives such an option may not exercise it for years – in many cases after the underlying stock's value has risen considerably.

On the other hand, Code Section 83 allows companies to take a compensation deduction on the day the employee exercises it. The deduction is equal to the spread on the stock's price from the day the company granted the option to its price the day the employee exercised it. Stock options give employees the right to buy company stock at a set price for a specified period, typically 10 years.

> **Example.** A company grants one of its employees a stock option when company shares are trading at $50. The employee waits five years, and exercises her option when shares are trading at $150. The company can now take a compensation deduction equal to the difference between the recent price and the price on the day the option was granted, or $100 a share, twice the amount of the expense it reported five years earlier.

"Companies pay their executives with stock options in part because right now," Coleman said, "those stock options often generate huge tax deductions that are two, three, even 10 times larger than the stock option expense shown on the company books." At the hearing, Acting IRS Commissioner Kevin Brown testified that the cumulative difference between the book expense and compensation deduction related to stock options for 2004 amounted to $43 billion – attributable to just 250 companies. "Those companies did not break the law," Coleman said. "They are benefiting from an outdated and overly generous stock option tax rule that produces tax deductions that often far exceed the companies' reported expenses."

If Congress does eventually act to change the rules, the likely intent first would be to end an incentive the tax code creates for "too many stock options on far too generous terms," Levin said. Levin believed the status quo created what Sen. Coleman called a "massive stock option book-tax gap," translating to lost revenue for the national treasury. To Levin, the other problem is a pay gap – he calls it a "chasm." Levin acknowledged stock options are a valuable and legitimate retention tool for executive talent. "However," he said, "anything can be problematic in excess, and I fear we have reached that point." In 2007, Levin said CEO pay was estimated at nearly 400 times average worker pay, compared to a pay gap of 300 times in 2004, and 100 times in 1990. "While I would agree that exceptional

performance demands exceptional pay," he said, "it is troubling to investors when mediocrity is rewarded with a king's ransom."

Levin has fallen short in earlier attempts to require stock option tax deductions to match the expenses shown on company books but he intends to try again. Levin has said recently that he may introduce legislation.

Is Executive Pay to Blame for the Economic Slowdown?

Some members of Congress are suggesting that executive pay is a contributing factor to the economic slowdown. As noted earlier, Congress released a report Dec. 5, 2007 that found "compensation consultant conflicts of interest are widespread." In a related hearing days later, Waxman grilled leaders of some of the country's largest consulting firms that provide advice on executive compensation and consulting services in other areas, a duality the report says gives rise to conflicts of interest.

"Reports of astronomical payouts to corporate CEOs have led many to question the fairness and effectiveness of the system for setting executive pay," Waxman said in a written statement.

"In many cases," the report said, "the consultants hired to advise on executive pay were simultaneously receiving millions of dollars from the corporate executives whose compensation they were supposed to assess."

'Perverse' Incentives?

The executive pay showdown took a distinct turn March 7, 2008, when executives appeared in Congress to testify before the House Committee on Government Reform and Oversight. The commitee turned its attention from consultants and their incentives to company officers' incentives. Waxman stated in opening remarks that executives' incentives are misaligned with the interest of the companies they lead, and have had disastrous effects on the national economy, particularly regarding the "debacle with subprime mortgages."

Waxman had written in a March 6 memo how "Three CEOs are linked by their involvement in the mortgage crisis. Countrywide, Merrill Lynch and Citigroup all profited enormously in the short term from their investments in subprime and other risky mortgages, and all three companies are suffering now as a result of these investments." The committee called in three current and past chief executives and a member of the compensation committees from each of their companies to testify. A panel of witnesses, including government officials and financial and corporate governance experts, described the causes and effects of the subprime mortgage and credit markets meltdown – attributing the crisis to poorly conceived incentives for chief executives.

Waxman and one committee member, Elija Cummings (D-Md.), called corporate perquisites into question. In a November 2006 e-mail, Countrywide Financial Services CEO Angelo Mozilo had criticized the Countrywide board for forcing him to pay taxes on his wife's travel aboard company aircraft when she "is traveling on a trip that is being done for company purpose." Mozilo raised the possibility of retiring if the board did not address this and other concerns. In that event, he wrote, he would receive millions in deferred compensation and director fees, and be able to liquidate his 12 million shares without restriction.

 ©Thompson Publishing Group

Cummings said during questioning, "I have some constituents who are losing their houses; you are upset about your wife." Mozilo apologized for the e-mail and said that when he wrote it, the company was doing well and that he would not have made such a request today. The exchange highlighted the critical view the committee's majority took of the executives' compensation and fringe benefits.

Waxman, in the March 6 memo, also questioned the $28 million in unvested stock options and $1.5 million in annual perquisites Charles Prince collected on his retirement from Citigroup. He was puzzled as to how these perks – including an office, an administrative assistant, and a car and driver for five years, as well as a commitment to pay taxes associated with the award of these benefits – were related to Prince's performance or benefited Citigroup shareholders, especially as in 2007 Citigroup wrote down more than $18 billion in write-downs related to subprime and other risky mortgages and its stock dropped by 48 percent from its five-year peak in December 2006.

Economic Impact Overstated?

"It's not a stretch at all," said Nell Minow, a corporate governance expert and edition and co-founder of The Corporate Library, to say that compensation incentives skewed in favor of volume, rather than quality, led to the extreme risk-taking and subsequent meltdown of financial markets. Minow told the committee that financial sector chiefs were making more money by putting together more deals, regardless of the deals' soundness. Later, by e-mail, Minow likened the current environment to a scandal some years ago at Sears Auto Repair, in which "the staff was paid based on numbers of repairs – obviously not a good thing for customers as the more times they had to bring back the cars because the repairs were ineffective, the higher the pay."

Outlook

Some government initiatives could benefit as pressure continues to mount on public companies and the marketplace to take some kind of action on executive pay, whether it be to require better disclosure or outright change. The Shareholder Vote on Executive Compensation Act (H.R. 1257) could once again see action, and other "say on pay" proposals have floated around Congress.

Minow pointed out other developments that may gain ground or push the market toward more shareholder control over executive pay. She said the SEC's decision to require mutual funds to disclose their proxy votes "is making it harder for money managers to ignore the importance of proxy voting as an investment decision." But she described as the "most significant of the post-Enron reforms" a growing trend toward adoption of "majority vote" requirements for election of directors. Shareholders currently may vote "for" a board of director candidate or abstain. Minow also mentioned that the New York Stock Exchange had floated a proposal to do away with broker votes on board members, to place more power in shareholders' hands.

With proposals on multiple fronts, the debate promises to stay alive until further changes, whether legislative or regulatory, succeed.

Even if government enacted no new laws or wrote no new regulations – the latter is an unlikely scenario – companies can look forward to continued pressure to improve their disclosures. Judging from the SEC's public comments in the past two years, companies should be prepared to be specific about the link between executive compensation and

individual executive performance, as well as the company's overall performance. They should be prepared to explain any penalties and rewards linked to performance of both kinds, in unambiguous terms.

Congress seems intent on pursuing conflicts of interest in executive pay, especially in the use of consultants. Consulting firms that provide multiple services to a publicly traded client, including executive pay advice, should be prepared to explain any potential conflicts of interest, and how they handle them. At least one consultant testified to Congress that his own company, itself publicly traded, followed a policy of not taking executive pay advice from outside consultants that provided other types of consulting work. A typical service fitting into the "other" category might be human resources or employee benefits administration. Generally, those other services generate income that dwarfs that brought in by executive compensation advice services. That same consultant testified that when his firm provided executive pay advice *and* other services, its clients always availed themselves of both knowingly. Consultants will need to continue providing such disclosures and, optimally, document their disclosure procedures.