# Are Executive Compensation Disclosures the Answer?

In-House News:

**Are Executive Compensation Disclosures the Answer?**
By Amy E. Wong

On Jan. 27, the Securities and Exchange Commission proposed more stringent executive compensation disclosure rules in hopes that investors will make more informed business decisions, but many are wondering if these measures are adequate.

Uncertain of how well the new rules would be received, the SEC opened itself up to public comment during a 90-day trial period. The commission will vote on whether or not they will continue with the proposals on April 10, 2006.

If the new rules are approved, the reporting of executive compensation will drastically change. With the SEC's 1992 disclosure requirements, many companies found ways to get around reporting executives' compensations by focusing on salary--a small part of total compensation--and omitting other more lucrative benefits.

The main provision of the revised rules, Compensation Discussion and Analysis (CD&A), demands companies to disclose the salary, retirement benefits, severance deals, tax payments, and deferred compensation of their five highest-paid executives.

The SEC's Chairman, Christopher Cox, supports the free market and believes that that the government should not regulate executives' compensations. He told commissioners at a Jan. 17 meeting that the proposal should "wage clarity, not wage controls." In order for the market to work properly, investors need to know in plain terms the amount and structure of executive pay.

A criticism of these tally sheets is that executives' exorbitant compensations would shock people and create hostility. *Forbes* reported in 2004 that the total compensation for CEOs had increased by about 30 percent since 2000 while the average household income had declined or remained flat--even when the economy was expanding. These tally sheets are called "holy cow" sheets because executives' high compensations often overwhelm people.

To put this in a broader perspective, Lucien Bebchuk, a Harvard Business School professor who studies executive pay, revealed that the 1,500 largest public companies compensated their top five executives $122 billion from 1999 to 2003.

Executives are paid by companies' boards, not companies' owners. As Bebchuk and Jesse Fried, co-author of *Pay without Performance: The Unfulfilled Promise of Executive Compensation*, explain in a Forbes article, because boards are unaffected by investors, "[they] have not been setting pay arrangements solely with shareholder interests in mind."

Furthermore, compensation packages may be detrimental to the company's long-term values. Bebchuk noted that executives liberally unload options that have attractive short-term payoffs. Instead of acting on behalf of the company's long-term prospects, many executives make decisions so that they themselves

profit--even at the expense of shareholders.

On Jan. 17, Commissioner Paul S. Atkins said in speech to the SEC, "The pay packages of some corporations may exacerbate [short-term vision] because corporate management may focus more on a company's stock price as a sole measure of success without considering long-term prospects."

Atkins hopes that the changes to executive disclosure will help investors determine whether a company is making sage decisions that have long-term prospects.

There are some, however, who think that the SEC's mandated salary disclosure is not enough to reform the market. Frank Coleman Inman, former business professor and corporate governance advisor, commented to the SEC, "Informing investors of top executive pay is a far cry from providing investors with the power to control this pay."

Frank is among shareholder activists who, according to an article in *Fortune*, want to adopt a "majority vote" requirement for directors. They want the power to elect and remove directors from corporate boards. In that case, directors would be directly accountable for shareholders' interests. In current practices, most nominees, who often run unopposed, become directors with simply one vote.

Inman said, "Stockholder resolutions to control or limit top executive compensation are usually considered merely precatory or advisory, and companies often ignore resolutions earning more than 50 percent of votes cast. The SEC and/or legislation can easily correct this by requiring publicly traded

corporations to adopt any stockholder resolution earning a majority of votes cast."

Bebcheck and Fried, who share Inman's sentiments, wrote in a *Forbes* article, "Shareholders should be given not only more information but also the power they need to use such information effectively."

*Corporate Counsel* reported that most observers expect the SEC to implement the new rules. The comments that the SEC has been receiving during the 90-day trial period have also been resoundingly supportive, except for a few that claim that the rule breaches personal privacy and is too difficult to comply with.

If approved, Principal Executive Officers, Principal Financial Officers, and the three most highly compensated executive officers must disclose their earnings. An article in *Corporate Counsel* suggested that many general counsels, who were among the top five executives at 190 of the *Fortune* 500 companies in 2004, will also be affected.

Michael J. Guerriero, Jr., compensation manager at American Standard Companies Inc., does not think that lawyers will be negatively affected.

"If anything, [compensation] will maintain its level or positively correlate to the added responsibilities [such as the DEF-14A filing process], similar to the trend in internal audit/Sarbanes-Oxley positions."

He continued, "My gut instinct tells me that most in-house corporate lawyers with this oversight will continue to act on behalf of the company because it will be in the company's best interest to provide more evidence of sound

governance practices and transparency in their disclosures.