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October 11, 2007

SEC Staff Observations in its Review of Executive Compensation and Related Disclosure

On October 9, 2007, the SEC's Division of Corporation Finance released a report discussing its principal comments provided to companies as a result of the staff's initial review of executive compensation disclosures under the new proxy reporting rules. From its comments to 350 public companies included in the review, two principal themes emerged. First, companies should provide more focused disclosure in the Compensation Discussion & Analysis (CD&A) on *how* and *why* they made specific executive compensation decisions. Second, the manner of presentation is important, and companies should use it to provide more direct, specific, clear, and understandable disclosure.

This letter summarizes the report's observations and suggestions to improve compliance. The full report may be found at www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm. Individual comment letters and company responses will be posted on the SEC's EDGAR website no earlier than 45 days from the date the staff completes its review of a company's filing.

- Companies could improve the manner in which executive compensation disclosure is presented. Suggestions include (1) making material disclosure items more prominent, and (2) shifting CD&A disclosure away from lengthy discussions on compensation program mechanics and process towards *how* and *why* compensation levels were established. A thorough "how and why" analysis should clearly explain (1) *how* did the company arrive at the levels and forms of compensation, (2) *why* did the company decide to pay that compensation, and (3) what were the results of the compensation decisions.
- Among the 350 companies included in its initial review, the SEC issued more comments on performance targets than any other disclosure topic. Suggestions to improve disclosure related to this topic include:
  - Disclose prior year and/or current year performance targets and/or achievements if it is material to understanding compensation decisions for the last fiscal year.
  - Clearly explain how qualitative inputs were translated into objective pay decisions and how individual performance was taken into account. The CD&A is not required to provide assessments of purely objective or quantitative criteria.
  - Disclose the performance targets or demonstrate that such disclosure could result in competitive harm.
  - Where performance levels were omitted, provide more specific disclosure as to the difficulty or likelihood of achievement.
  - Disclose how non-GAAP financial performance measures are calculated.

- The required compensation tables should follow, not precede, the CD&A because the CD&A is intended to serve as an overview of compensation disclosure that puts the compensation tables into context.
- Eliminate boilerplate language. A significant number of companies were asked to replace boilerplate language with discussion specific to its own facts and circumstances.
- Discuss how amounts paid or awarded as one compensation element impacted the company's decision to pay or award amounts as other compensation elements.
- Policies and decisions for individual named executive officers that are materially different than for the other officers should be discussed separately from group policies and decisions.
- Provide sufficient disclosure as to how benchmark compensation information was used and how it affected compensation decisions. The CD&A should also identify the companies included in the benchmark peer group. If the company is able to exercise discretion in its use of the data, then discuss the nature and extent of that discretion and whether or how it was used.
- Disclose the rationale behind the material terms of termination arrangements and how these arrangements influenced other compensation elements, if applicable.
- Provide a total for the amounts payable to each named executive officer upon termination of employment or a change-in-control.
- Identify the parties involved in the compensation process, including who made compensation decisions. Describe the role of executive officers in determining or recommending the amount or form of compensation, especially that of the chief executive officer.
- Be specific and comprehensive in the disclosure related to the use of compensation consultants by including the nature and scope of the consultant's assignment and material instructions provided to them by the company.
- Additional charts, tables, and graphs not explicitly required under the SEC's disclosure rules are helpful in enhancing investors' understanding of the information. However, alternative compensation tables should be presented less prominently than the required tables and it should be made clear that these alternative tables are not required under the disclosure rules.

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