


**Potential Proxy Pitfalls & Perils
(for Stock Plans)...
And How to Avoid Them**

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Agenda

Reg S-K

- Item 201
- Item 402
- Item 403
- Item 405

General Proxy Disclosure Tips & Tools

e-Proxy

- Notice & Access
- Full Set

Reg S-K Item 201

Reg S-K

- Item 201
 - Market info
 - Holders
 - Dividends
 - Best Practice to discuss policies on RSAs/RSUs as well
 - Securities Authorized for Issuance under Equity Comp Plans
 - Performance graph

Item 201 – Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column a) (c)
Equity Compensation plans approved by security holders			
Equity Compensation plans not approved by security holders			
Total			

Item 201

Pitfalls

- Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)
 - Unvested RSUs should be included
 - Deferred RSUs (vested but not delivered) need not be included
 - RSAs not included in “to be issued” (they have already been issued)
- RSU “price” should be excluded from weighted-average exercise price
 - Footnote to explain
- Failure to include evergreen formulas in a footnote
- Acquisitions
 - Include plans you acquired
 - If approved by target shareholders but not yours – unapproved only if shares will be granted from the plan in future

Regulation S-K

Reg S-K

- Item 402
- “New Rules” released on August 29, 2006
 - Quickly amended again on December 22, 2006
 - Summary Comp Table & Director Comp Table
 - » Show expense accrued, rather than grant-date fair value
 - Plan-based Grant
 - » Added grant-date fair value column (I)

Regulation S-K

Reg S-K, Item 402

Paragraph	Table	Abbreviation
402(a)	General Overview, All Compensation, Who's Covered	
402(b)	Compensation Discussion & Analysis	CD&A
402(c)	Summary Compensation Table	SCT
402(d)	Grants of plan-based awards table	Grants
402(e)	Narrative of SCT & GPT	
402(f)	Outstanding Equity Awards at Fiscal Year-end	Outstanding
402(g)	Option Exercise and Stock Vested Table	Exercises & Vestings
...		
402(k)	Compensation of Directors	DCT

(a) Whom to Include?

402(a)(3)

- All Principal Executive Officers (PEO) and Principal Financial Officers (PFO) for the year
- Three most highly-compensated executive officers other than PEO and PFO serving as of end of the year
- Up to two more former officers
 - Would have been included, except not serving at end of year

(a) Whom to Include?

Pitfalls:

- If NEO, other than PEO or PFO, include data for any covered year in which they were executive officer
- PEO and PFO, if exec in year 1, NEO in year 2, and CEO in year 3, only include year 3
- If NEO left (and thereby was paid less), consider compensation that was actually paid, not annualized
 - However, since this often includes severance payment, they are often included even though “wages” were not as high
- If you have multiple CEO's or CFO's during the year, you must include all of them in the tables

(a) Whom to Include?

Pitfall:

- Include the wrong people because not all comp considered
- “We failed to consider recognized stock comp during the fiscal year as a component of compensation in our NEO analysis. Our three additional named executive officers completely changed once we realized this oversight. Will never do that again!”

Prevention:

- Add up ALL the numbers for all execs (including former) FIRST, don't pick a few then add
- More work, but prevents the problem

(a) Whom to Include?

“Apparently if someone is an NEO in 2007 and stops being an NEO in 2008, the proxy for the year ended 2008 still should include this person in the tables with their annual and/or year-end information!”

- **Incorrect**
- Former NEOs from last year (other than PEO and PFO) not included in proxy unless in “former that would have been in top three”...

(b) Compensation Discussion & Analysis

Discuss compensation awarded to, earned by, or paid to NEOs

- Objectives
- Designed to reward what
- Elements
- Why each element chosen
- How amount determined
- How elements fit into overall comp objectives

(b) Compensation Discussion & Analysis

Analysis is Job One

- SEC Staff not yet satisfied with the quality of the analysis from many companies
- “how and the why”
- Explain connection between compensation philosophy and policies and amounts shown in tables
- Should:
 - Address each material compensation element
 - Describe how arrived at varying levels of comp paid
 - Explain why Comp Committee believes comp practices and decisions fit within overall pay philosophy and objectives

(b) Compensation Discussion & Analysis

Incentive Compensation is Central

- How and why performance metrics selected
- Disclosing the target levels established for metrics
- Avoid temptations
 - Claiming “competitive harm” to shield information
 - Disgorging the details in a vacuum

Competitive Positioning Important too

- Benchmarking
 - Disclose companies in peer group
 - How was peer group selected
 - relationship between actual compensation and data used

(b) Compensation Discussion & Analysis

Excessive Risk

- Emergency Economic Stabilization Act of 2008
 - Imposed on TARP recipients
 - Requires annual review of comp to ensure not encouraging “excessive risk”
- Prudent for Comp Committees to consider risks execs might be motivated to take to meet performance targets
 - If considerations form material part of comp policies or decisions, should be addressed in CD&A

Recovery Policy

- TARP recipients required to implement policy for recovery of bonus or incentive compensation paid
- If payments based on materially inaccurate financial statements or performance metric criteria
- Consider including in your CD&A

(b) Compensation Discussion & Analysis

More Pointers from Mark at in latest Thoughtful Pay Alert:

- http://www.compensia.com/tp_alerts/TP_EnhancingExecCompDisclosure_0109.pdf

(c) Summary Compensation Table

Name & principal position (a)	Year (b)	Salary (\$) (c)	Bonus (\$) (d)	Stock Awards (\$) (e)	Option Awards (\$) (f)	Non-Equity Compensation (\$) (g)	Nonqualified Deferred Compensation Earnings (h)	All Other Compensation (i)	Total (\$) (j)
Jane Smith, CEO	2008								
	2007								
	2006								

Fair Value Accrued (for all grants) during year

- Not reduced by estimated forfeiture
- Retirement eligibility acceleration too
- Liability awards, also show accruals
- Deduct & footnote fair value accrued for forfeited awards
 - Could result in negative amount
- Only include performance awards if achievement probable
 - True up as assumptions about achievement change
- Footnote fair value assumptions (generally incorporated by reference to 10-K)

(c) Summary Compensation Table

Pitfalls:

- Exchanges – don't forget incremental expense!
- All other compensation
 - Include dividends on RSAs/RSUs only if not included in fair value
 - Payroll Codes
 - Payroll groups have many different codes
 - Not always clear what comprises "other income" number
 - Be sure to understand what makes up the total
 - Not disclosing something that SHOULD be included
 - Including something that should be EXCLUDED
 - Strong documentation very important

(d) Grants of Plan-based Awards Table (Grants)

Estimated Future Payouts Under Non-Equity Incentive Plan Awards				Estimated Future Payouts Under Equity Incentive Plan Awards				All Other Stock Awards: Number of Shares of Stocks (#) (i)	All Other Stock Awards: Number of Securities Underlying Options (#) (i)	Exercise or Base Price of Option Awards (\$/Sh) (k)	Grant-Date Fair Value of Stock and Option Awards (\$) (l)
Name (a)	Grant Date (b)	Threshold (\$) (c)	Target (\$) (d)	Maximum (\$) (e)	Threshold (#) (f)	Target (#) (g)	Maximum (#) (h)				

- If less than closing market value, add column showing closing price
- 32% of NASPP survey respondents didn't use closing price

Include incremental expense from modifications (exchanges, etc.)

(d) Grants Table

Pitfall:

- If performance grants have Targets and Maximum,
 - Grant Date Fair Value should only be the FAS123(R) value of the **Target** not maximum
 - May be some disagreement on this point

(e) Outstanding Equity Awards at Fiscal Year-end Table (Outstanding)

Name (a)	Option Awards				Stock Awards				
	Number of Securities Underlying <u>Unexercised</u> Options (#) <u>Exercisable</u> (b)	Number of Securities Underlying <u>Unexercised</u> Options (#) <u>Unexercisable</u> (c)	Equity Incentive Plan Awards: Number of Securities Underlying <u>Unexercised</u> <u>Unearned</u> Options (#) (d)	Option Exercise Price (\$) (e)	Option Expiration Date (f)	Number of Shares or Units of Stock That <u>Have Not Vested</u> (#) (g)	Market Value of Shares or Units of Stock that Have Not Vested (\$) (h)	Equity Incentive Plan Awards: number of <u>Unearned</u> Shares, Units or Other Rights That <u>Have Not Vested</u> (#) (i)	Equity Incentive Plan Awards: Market or Payout Value of <u>Unearned</u> Shares, Units or Other Rights That <u>Have Not Vested</u> (#) (j)
Jane Smith									

Not Vested, Time-based
Not Vested, Performance-based
Not Vested, Time-based
Not Vested, Performance-based

(e) Outstanding Table

Pitfalls:

- Incorrect market value (h) & (j)
 - Should be computed based on year-end closing price
 - Intrinsic value (not the FAS123R value)
- Misunderstanding “unearned” vs. “unexercisable”
- Failure to include transferred grants
 - If beneficial ownership continues

(f) Option Exercises and Stock Vested Table (Exercise & Vestings)

Option Awards			Stock Awards	
Name (a)	Number of Shares Acquired on Exercise (#) (b)	Value Realized on Exercise (\$) (c)	Number of Shares Acquired on Vesting (#) (d)	Value Realized on Vesting (\$) (e)
Jane Smith				

Include transfers (value at time of transfer)

Footnote amounts deferred from RSUs

(g) Director Compensation Table (DCT)

Name (a)	Fees Earned or Paid in Cash (b)	Stock Awards (\$) (c)	Option Awards (\$) (d)	Non-Equity Incentive Plan Compensation (\$) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$) (f)	All Other Compensation (\$) (g)	Total (\$) (j)
Jane Smith							

Expense Accrued During the Year

- Same rules as for SCT
 - Not reduced for estimated forfeiture rate
 - But more footnotes since there isn't a "grant table" for Directors
 - Grant-date fair value
 - Footnote incremental expense from modifications
 - Footnote forfeitures

403(a) Beneficial Ownership Table

Reg S-K Item 403(a)

- Who?
 - More than 5%
 - All persons reported under 402?
 - Director Nominees
 - All officers, not just NEOs
 - Not former PEOs, PFOs
- What?
 - Shares beneficially owned
 - Different than section 16 beneficial ownership
 - » Dispositive control & voting control
 - Shares becoming beneficially owned within 60 days
 - Options – becoming exercisable
 - RSA/RSU – vesting

403(a) Beneficial Ownership Table

Name	Amount and Nature of Beneficial Ownership	Percent of Class

Pitfall:

- Becoming exercisable in 60 days
 - Don't forget RSAs/RSUs!
- Total percentage
 - Add the exercisable/releasable within 60 days into both the numerator and denominator
 - Done on individual basis
- Table is not as of the end of fiscal year, as current as is practicable
 - Moving target, especially if filing date changes, must update

Section 16(a) Beneficial Ownership Reporting Compliance

Reg S-K Item 405

- Beneficial Ownership Reporting Compliance
 - Identify anyone who failed to file on a timely basis
 - Number of late reports
 - Number of transactions not reported on a timely basis
 - Known failures to file

General Pitfalls

Pitfalls

- For tables that are “new” with revised proxy disclosure rules
 - Forgetting this year you need three years of data!
 - All Other Comp
 - Only one year required
 - All other columns, only need to include three years, if material to understanding most recent year
 - Footnotes only for one year
- 423-Qualified ESPP Gains are exempt and need not be reported

Pitfall: Failure to communicate...

Start meetings with all players early!

- Make sure to be included in preliminary drafts
- Invite yourself to meetings
- Start early
 - Start in September for proxy in April
 - Director & Officer Questionnaires send out in January / Early February

Tip: Get Smart(er)

Be familiar with all the areas equity plans are disclosed

- Summary Comp Table
- Grants Table
- Outstanding Table
- Exercises/Vestings
- Director Comp Table
- Beneficial Ownership Table

Don't just supply numbers as requested (in a vacuum)

Ask to see number in the context of the report

- May change your interpretation of what is being requested

Tip: Pay Attention to Terminology

Definitions vary

- Few standards exist and same term used differently in different regulations
- Example: "Beneficial Owner"
 - Reg S-K Item 403
 - Sole or shared voting power
 - Sole or shared investment power
 - Section 16
 - Any person or entity with sole or shared power to vote or dispose of the stock AND
 - Includes holder who enjoys the economic benefits of ownership although shares held in another name
 - » For example, one spouse generally deemed beneficial owner of shares held by other spouse

Tip: Start a Glossary

Stock:

- Instruments such as common stock, restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or any similar instruments that do not have option-like features

Option:

- Instruments such as stock options, stock appreciation rights and similar instruments with option-like features. The term stock appreciation rights ("SARs ") refers to SARs payable in cash or stock, including SARs payable in cash or stock at the election of the registrant or a named executive officer.

Equity

- Used to refer generally to stock and/or options.

Beneficial Owner

- Sole or shared voting power; Sole or shared investment power

Pitfall: Unaware of System Capabilities

“Our clients often don’t seem to know about the proxy reports, so try to use the expense reports instead.”

“I asked one my team members to prepare the FAS123R expense with no forfeiture and she calculated the whole thing manually. My bad, I should have told to run the expense report and group by person, but I thought she knew that.”

Pitfall: Unaware of System Capabilities

“One client asked us to modify a participant summary report for them to calculate it as of year-end, we asked why... after going around and around it turned out they needed the number for proxy reporting. We pointed them to **the FIVE proxy reports we already had.**”

Tip: Talk to Your Vendor!

If you're unaware that they have proxy reports, ask

- Many systems/software have reports specifically designed for proxy reporting
- If you are unfamiliar with those reports, reach out to your vendor for help

Tip: Proxy Binder

Keep a binder with all your notes from Proxy last year

- Copies of reports you ran
 - Make sure you know how it was filtered/sorted so you can reproduce (if needed)
 - If your system does not automatically note "input parameters" on the report
 - » Write them down on the report OR
 - » Take a screenshot of the report parameters window as you run the report
- E-mails sent regarding number requested, questions that came up
- Notes to yourself about issues you had

Print out the proxy and attach hardcopies of your supporting documentation

- Back up at your fingertips if you need it

Tip: Reach Out

Have a non-lawyer "outsider" review for understandability

- SECs plain English principals
- Should not need a law degree (or CPA or CFA) to understand
- Have others read footnotes to ensure they are footing to each other

e-Proxy

Notice & Access (2006)

- SEC amended the proxy rules under 1934 Act
- Provides alternative method to furnish shareholders proxy statement & annual report
- Post on web site and provide shareholders with notice of availability
- Hard copies must also be made available to shareholders at no charge on request

Internet Availability Even if Notice & Access Not Used (2007)

- SEC amended proxy rules to require
 - Posting of proxy materials on a web site and
 - Provide shareholders with notice of Internet availability of materials

e-Proxy: Notice & Access

Must send “Notice of Internet Availability of Proxy Materials” 40 days before shareholder meeting

Cannot include proxy card

Can include notice of shareholder meeting

Proxy card sent only 10 or more days after Notice sent

- if hardcopy proxy materials not included, include Notice again

Cannot be used for business combination transactions

Shareholder can elect to receive paper or e-proxy and election stays in effect until revoked by shareholder

e-Proxy: Full Set

All issuers must prepare Notices and create qualified web sites, even if not using notice and access (sending “full set” instead)

- All issuers must:
 - Post materials on Internet web site on same terms as N&A and
 - Include Notice with full set of proxy materials
 - Or include the Notice information in the proxy statement and proxy card
- Other requirements of notice and access do not apply, such as:
 - Requiring web site provide a method to execute proxy
 - Having materials posted 40 days before the meeting

Pitfall: e-Proxy

Don't forget about option/RSU holders/ESPP enrollees

- Must receive all the same proxy materials as “regular” shareholders
- Most companies use negative consent and distribute via intranet/e-mail

e-Proxy Problems

“75% fewer retail shareholders participating and less than 1% actually going to the designated website and then accessing the proxy materials prior to voting.”

- IR Web Report, “7 fixes for the SEC’s notice-and-access proxy process”, November 18th, 2008
- <http://www.irwebreport.com/daily/2008/11/13/7-fixes-for-the-secs-notice-and-access-proxy-process/>

Tips: e-Proxy

Know your shareholders

- Do you rely on “retail” shareholders?
 - If so, Notice & Access may not be for you?
- Expect a significant reduction in votes
 - Should begin to increase again as shareholders become aware of and familiar with new procedures
- Consider sending full-copy to
 - Larger retail shareholders
 - Shareholders who vote regularly
 - (Allowed to use Notice & Access only for some)

Tips: e-Proxy

Convenient Format

- May require two different formats
 - Consider shareholders w/o broadband connections
 - Image files are common
 - Large and slow to download
 - Can't be searched
 - Consider making financial statements available in Excel too

Make your notice user-friendly & easy-to-read

- Take tips from your marketing group
 - How do you get recipients to act on a mailing?
- Keep fonts larger

Increase chances of having mail opened (instead of thrown out)

- Put company logo on the envelope?
- "Important Proxy Materials Enclosed"?

e-Proxy Notice Example

ABC-1 Corporation

000 MOTORPARKWAY, SUITE 900, ANYWHERE, USA 11111-1111

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on
Monday, January XX, 200X

The Proxy Statement, Annual Report and other proxy materials are available at:
<http://bnymellon.mobular.net/bnymellon/abc>

ABC-1 CORPORATION

JOHN M. DOE
100 SMITH DRIVE
ANYWHERE USA XXXXX-XXXX

BAR CODE
RESTRICTED
AREA

This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.

If you want to receive a paper or e-mail copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before January XX, 200x to facilitate timely delivery.

*Courtesy of BNY Mellon Shareowner Services.

e-Proxy Cookie “Myth”?

The SEC Regs say that the site on which materials are hosted must:

- “Maintain [the site]... in a manner that does not infringe on the anonymity of a person accessing that Web site.”
- “...Refrain from installing cookies and other tracking features on the Web site on which the proxy materials are posted.”

What is a “cookie”?

- Bits of text sent by a website to a web browser, stored on the computer, then sent back unchanged by the client each time it accesses that server
- Used to
 - Differentiate users & maintain user-data related during navigation, sometimes across multiple visits
 - Shopping carts
 - Remember me
 - Personalization (font size, local weather, etc.)

e-Proxy Cookie “Myth”?

Some argue that this means the site must be “cookie-free” which often means hosted by a third party.

- Others suggest that “cookies” are okay as long as they do not compromise the anonymity of the shareholder.
- <http://www.irwebreport.com/daily/2008/01/04/dispelling-the-cookie-myth-around-e-proxy/>

Questions?

 **Compensia**
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 **Stock & Option Solutions**

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