# COMPENSATION DISCUSSION AND ANALYSIS TEMPLATE

Second Edition

CFA Institute

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CFA Institute is the global association of investment professionals that sets the standards for professional excellence. We are a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community.

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# Introduction

Since the first edition of this template was published in 2011, many best practices in compensation discussion and analysis (CD&A) have emerged. We wish to highlight these best practices to aid companies currently struggling with the CD&A process or with limited resources and to clarify the elements of disclosure that are most useful to investors. All companies can find something in this report to improve their communications documents.

The CD&A is a company's primary engagement tool with investors and, therefore, needs to tell a company's compensation story in a concise manner that investors will understand. The CD&A is also used to comply with US SEC requirements,[1] but thinking of it first and foremost as a compliance document misses the opportunity to communicate effectively with investors.

As many shareowners and markets around the world continue to scrutinize executive pay practices, we hope that this template will improve understanding, serve as a global model for improved investor communications about this important issue, and elevate compensation disclosure beyond an exercise in legal compliance.

The sections of the model CD&A are arranged in order of importance from an investor's perspective, starting with an overview of the company's corporate performance for the previous year and an explanation of the link between that performance and executive pay. The remaining sections delve into detail about compensation elements and decisions, compensation-setting process and policies, and other areas of interest.

CFA Institute, in partnership with the CD&A working group, offers this CD&A template as a step toward making compensation communications clear and relevant to investors. To achieve these goals, the working group members agreed that the template should help issuers produce a CD&A that, like any good communications document, tells a clear and easily understood story.

[1]See Appendix D.

### CD&A Working Group

For the working group, CFA Institute assembled a distinguished group of experts, including issuers, investors, proxy advisers, lawyers, and other parties who play a role in the CD&A process.

## The Template

This CD&A template offers companies a guide to help ensure that the CD&A is a clear, concise, and understandable tool for communicating to investors the company's approach to its executive compensation program. Essentially, it gives insight into the analytical underpinnings of the numbers reflected in the tabular and other disclosures that follow the CD&A.

A good CD&A needs to answer the questions **"How?"** and **"Why?"** concerning compensation decision making at a company.

Companies and compensation committees should view this CD&A template as a flexible template, particularly because the CD&A should be a properly customized story and should not devolve into "boilerplate" language. The goal is to use the template approach to include the basic elements of the compensation narrative in a manner that best tells a company's compensation story. This template is designed as a best practice source for creating a CD&A that is a clear, concise, and legally compliant representation of a company's unique, and often complex, compensation scheme.

# I. Executive Summary

Companies should provide the essential data shareowners are looking for in a short summary. Essential information includes the following:

- What has changed (strategy, leadership, pay philosophy, pay practices) in the past year
- Most recent say-on-pay vote results and engagement activities
- Pay governance practices
- Elements of compensation
- Annual and long-term metrics and performance
- Link between pay and strategy

We encourage the use of user-friendly charts and graphics for such information. For an example that contains this list, see **Figure 1**.

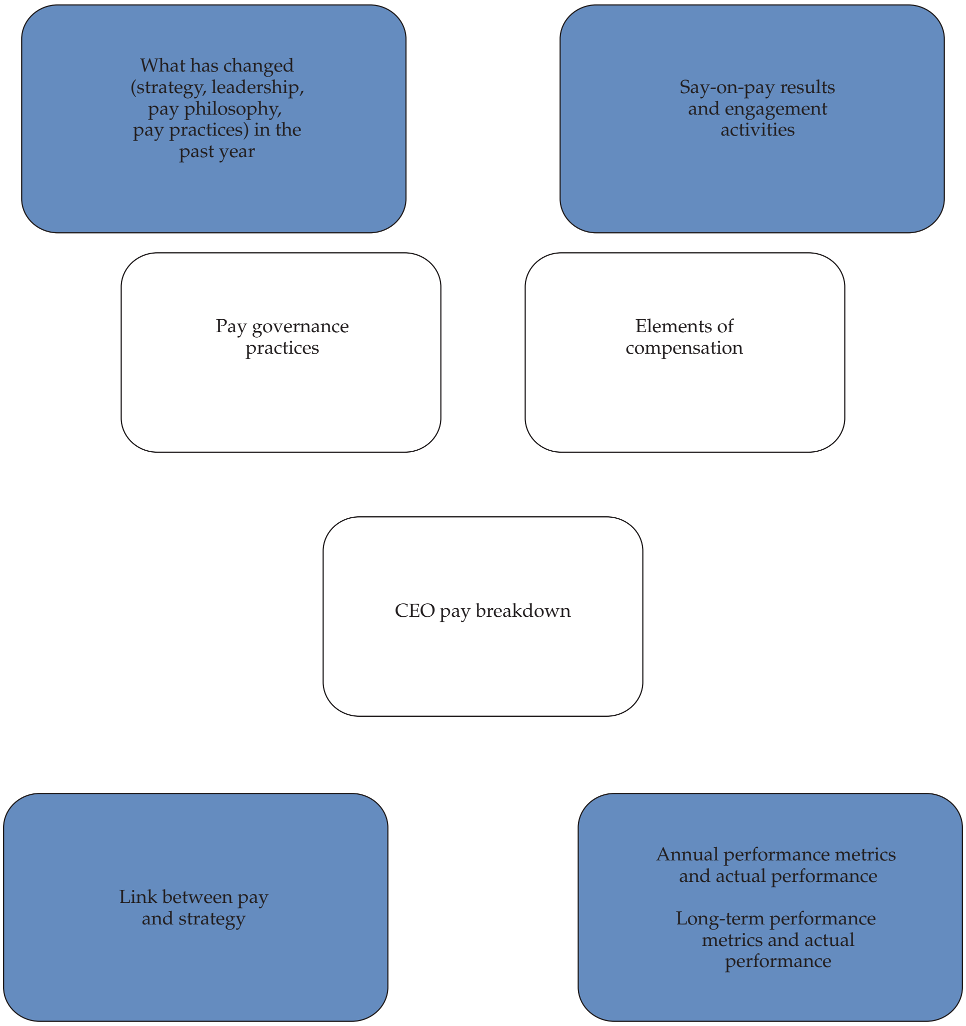
The information in the graphic summary in Figure 1 can easily be contained on one or two pages of the proxy statement to provide a summary of the most meaningful information. This graphic summary is, of course, only one suggestion of what a summary should contain. The CD&A working group believes, however, that such a summary goes a long way toward giving investors most of the information they are looking for at the very beginning of the CD&A. More detail on each of these items can then be provided in the remainder of the CD&A.

Other items companies place in their executive summaries include the following:

- A summary of the company's performance over the past year
- Key compensation decisions made in the past year (a more detailed review comes later)
- What (by amount and type) was paid or awarded (including awards payable in future periods) to named executive officers (NEOs) and how each element of pay is linked to performance
- Peer group information—especially if there were any material changes

Companies organize this information in the order or format that they prefer that will communicate to investors the story of their executive compensation over the past year. We wish to emphasize the power of using concise and direct language to convey this story. CD&A working group members agreed that such a succinct overview can be conveyed in one to two pages. For more ideas on what to include in this section, please look at the best practices provided in Appendix B.

**Figure 1. Compensation Discussion and Analysis Graphic Summary**



# II. Elements of Compensation for the Past Fiscal Year

## *Section Points of Emphasis*

- *The main compensation tools the company uses to motivate and retain executives*
- *The approach the company uses in valuing equity incentives*

The various elements of executive compensation should be defined in this section. A statement disclosing the elements of compensation for the CEO and other NEOs should be provided. The discussion should give a typical investor a clear understanding of what each specific element is and what each element is designed to reward. This section aims simply to define the various components of the compensation plan. Discussions of such issues as "realized" versus "realizable" pay[2] may be best introduced here.

### Realized vs. Realizable Pay

- Realized pay—pay that an executive is actually awarded in a given year
- Realizable pay—potential value of pay awarded over a specific period of time and valued at a specific point in time

For examples of realized vs. realizable pay, see Appendix B.

Preparers should present this information in an easy-to-read format, such as a table or bulleted list, with the elements of compensation identified. The compensation committee should explain why each element was chosen, how those elements work, and how each element links to the company's business strategy.

A company should take the opportunity here to very deliberately address the rationale for unique and potentially controversial pay practices and decisions.

[2]The following resources provide discussions of realized versus realizable pay: *Trends in Realized/Realizable Pay Disclosure: Top 250 Companies*, Frederic W. Cook & Co. Inc. (2014); *Executive Pay Disclosure: Realized and Realizable Pay*, Compensation Advisory Partners (2014); *Supplemental Pay Disclosure: Overview of Issues, Proposed Definitions, and Conceptual Framework*, The Conference Board (2013):5.

# III. Performance Targets for Past Fiscal Year/Performance Period

Many companies combine Sections III and IV in their CD&A disclosures. We separated them here for clarity, but companies should do whatever best tells their story.

## *Section Points of Emphasis*

- *The company's short-term and long-term performance targets and how they relate to the company's strategy and operating plan*
- *Total CEO/management compensation versus stock performance*

Many companies explain their short-term and long-term plans separately to clarify the nuances of each plan.

The CD&A should comment on the individual and corporate performance goals selected, why these performance goals were selected, the rigor of the performance goals, how incentives are tied to these performance goals, and how compensation reflects actual corporate and individual executive performance. Companies should describe how the incentives align with strategic objectives and enhance the company's performance. This discussion should disclose the following:

a. In straightforward terms, annual and longer-term performance targets (including specific numeric targets), nonfinancial or environmental, social and governance targets, and the extent to which such targets were achieved

b. Remarks on the company's ongoing business direction and expectations and how they may influence future targets

Some of this information can be effectively presented in a different context in other places.

It is a good idea to emphasize the cohesive discussion of the design and outcome of each plan that includes performance conditions (short term and long term). The following elements should be tied together:

- Design of plan
- Basis for target awards
- Performance metrics—reason for choice(s)
- Goals set for each metric—how they relate to the business climate or other considerations and also to prior goals
- Basis for payouts—goal attainment versus payout amount

# IV. Compensation Decisions Made in Past Fiscal Year/Performance Period

## *Section Points of Emphasis*

- *Company performance relative to targets*
- *Effects of individual and company performance on compensation*

A company should discuss the actual compensation decisions made during the previous year to the extent these decisions relate to salary, annual or long-term incentives, or other material elements of compensation, including the following:

a. Salary or bonus and, to the extent a bonus or salary increase is guaranteed, the reason for the guarantee

b. Specific performance targets on which each compensation element is based and whether the targets were achieved

c. Material increases or decreases in any elements of compensation, with an explanation of the changes

d. In summary form, any other material types of compensation, such as executive perquisites, consulting agreements, severance payments, or tax-related payments that may result or have resulted in payouts to the executive or the executive's family

e. The use of tax gross-ups (if any) and why they are provided

f. Discretionary compensation linked to individual executive performance rather than specific quantitative goals and how/why this compensation supports the company's long-term strategic goals

Many companies now disclose this information in a table or bulleted list that succinctly reviews the information. Best practice includes a discussion of *why* each decision was made. Discussions of equity-based and other long-term incentive compensation should also provide a summary of one-off awards and other compensation that may be nonrecurring in nature and an explanation of why such awards occurred. The company may also discuss here the realization of gains by key executives from long-term performance targets (such as long-term performance awards that have been earned or vested over a period greater than a year).

# V. Compensation Framework: Policies, Process

## *Section Points of Emphasis*

- *The principles underlying the company's compensation policies*
- *The company's compensation policies*
- *The board's compensation-setting process*
- *The role risk plays in compensation decisions*

## Compensation Policies

This section of the CD&A can address investor questions about what the company does in regard to compensation and why. A company should briefly discuss the principles of its executive compensation framework, including the key considerations it makes when setting pay. The working group emphasizes that this discussion should be brief, should clearly communicate a company's compensation philosophy, and should avoid boilerplate language. Some of the considerations a company may address are the emphasis on performance in the compensation structure, the emphasis on future pay opportunity versus current pay, the discretionary nature of compensation programs, whether executives have employment contracts, and the portion of variable ("at risk") compensation. Many companies have begun to disclose this information in a user-friendly tabular format.

A best practice emerging for a CD&A is called "pay governance."

Based on a review of many of the proxies highlighted in Appendix B, we consider that pay governance generally boils down to a discussion of "what we do and what we don't do." You can review the proxies for yourself to see examples, but here is a summary of what you'll see:

What we do:

- Clawbacks
- Share ownership requirements
- Tally sheets
- Engaging with shareowners
- Risk assessment of pay
- Annual say on pay
- Double-trigger severance agreements
- An independent compensation consultant for the board
- A cap on long-term and incentive awards
- Limits on perquisites

What we don't do:

- Tax gross-ups
- Employment agreements
- Payment of dividend equivalents on unearned shares
- Stock-option repricing
- Hedging or pledging
- Single-trigger equity acceleration
- Supplemental retirement plans

Some companies have used this section of the CD&A to highlight best practices in compensation and compensation disclosure and to discuss why the company has or has not adopted such practices. Some have even taken the step to highlight poor compensation practices and discuss why the company does not engage in such practices.

In this section, a company should discuss its compensation policies to help investors understand ways the compensation committee and the board have aligned management and shareowner interests. The company also should discuss the frequency and results of the company's advisory (or binding) vote on executive pay packages.

Descriptions of policies concerning equity-based and other long-term incentive compensation should summarize the following:

a. Vesting periods and retention requirements

b. The timing and pricing of stock-option grants and other stock-related awards

c. The policies related to repricing or exchange of stock options or other stock-related awards if the action occurred during the last fiscal year, has been approved, or is pending

d. Stock ownership guidelines for NEOs and board members

e. Performance targets

f. Material tax or accounting treatments

g. Policy on the hedging of company stock by executives and board members

h. Clawback provisions

i. Policy on the modification of performance targets

## Compensation Process

The CD&A should clearly illustrate the process undertaken to link compensation, corporate strategy, and performance and should answer the question, How does this compensation framework drive results at this company? A company should discuss the process the compensation committee undertook with management, the board, and compensation consultants in setting and implementing executive compensation. This section should allow the investor to obtain a clear sense of how and why compensation targets are determined and awards made. A company also should discuss the level of discretion exercised by the compensation committee, on the upside and downside, in setting executive compensation. This is a section of the CD&A in which the compensation committee can speak to its process for engaging with investors. Items covered in the narrative should include the following:

a. The role of compensation consultants and management in the determination of compensation. This discussion should focus on how advice from the compensation consultants is reflected in the compensation committee's decisions in setting executive compensation.[3]

b. A statement addressing the independence of the compensation consultants from company management and a discussion of (or a reference to) the information concerning how consultants are compensated for this work and other consulting work for the company unrelated to the specific executive compensation engagement.

c. The use of benchmarks for compensation targets.

d. Whether and how a peer group is used in the determination of compensation for the CEO and other NEOs. If a peer group is used, the selection criteria for that peer group should be discussed. If different peer groups are used for different officers, an explanation should be provided.

e. Changes to the list of peer group companies. If a change has occurred in the peer group in the past fiscal year, an explanation should be provided.

f. The company's process for engaging with shareowners on compensation issues and the results of engagement efforts over the past year—or longer, if appropriate.

The compensation committee is not required to address in the CD&A risks arising from a company's compensation plan, although some companies have done so to assure shareowners that a company's executive compensation is aligned with prudent risk taking and risk management.

[3]In June 2012, the SEC approved new rules to implement Section 952 of the Dodd–Frank Act, which mandates disclosure of whether the work of the compensation consultant has raised any conflict of interest with the issuer and, if so, the nature of the conflict and how the conflict is being addressed.

# VI. Employment and Termination Agreements

Employment and separation or termination agreements can be depicted in a brief chart. A succinct disclosure could be a chart that summarizes the details of the plan, including potential termination amounts, and shows what triggers a payout. The chart would include a link to the original document in which it was disclosed.

## *Section Points of Emphasis*

- *The guaranteed compensation to executives during employment and in the event of termination/severance*

The CD&A should disclose whether executive employment and termination agreements are used and the rationale for their use (why they benefit shareowners). This section should also summarize the material terms of executive employment and termination agreements. It should note stipulated salary or bonus guarantees and total payouts resulting from potential termination scenarios and instances of accelerated vesting or retention requirements postemployment. This section can also address connections between these agreements and the other elements of the compensation plan. Specific items to be addressed, if applicable, include the following:

a. Guaranteed salaries or bonuses or other benefits per the employment agreement

b. Duration of employment and associated termination issues as stipulated by the employment agreement

c. Potential termination circumstances and the resulting outcomes

d. Payment from postemployment agreements resulting from the triggering of a single event (e.g., change in control) rather than a double trigger (e.g., change in control and subsequent termination)

e. Rationale for termination payments totaling multiples of annual salary and bonuses

f. Accelerated compensation or immediate vesting of otherwise unvested equity incentives and associated retention requirements

# Appendix A: Best Practices in CD&A Preparation and Execution

## Preparation

- The CD&A is a communications document and the first phase of engagement with investors. For many companies, if the CD&A is done well, it may be the only phase.
- Plan ahead. Set a schedule for CD&A production far in advance and ensure that everyone involved in the process knows their roles.
- Engage with investors before the process starts to gauge any concerns they may have. Engagement builds discipline of understanding into your company's compensation structure, builds trust with investors, and helps inoculate a board from many surprises.
- Ensure that investors know who to contact with comments or concerns they may have—the investor relations (IR) office, the corporate secretary, a chief governance officer, or some other individual. Investors need to know that their legitimate questions and concerns reach the proper individual or group—be that management or the board.
- When appropriate, designate appropriate board members to meet with shareowners and be clear on what they can and cannot discuss.
- The CD&A drafting process should include input from a variety of internal constituents (e.g., legal, IR, corporate secretary, corporate communications) to ensure that the CD&A effectively tells the company's compensation story.
- Think about the target audience—the investor. Does the CD&A speak to that audience?
- Maintain some continuity in the team writing the report. Have the person who is ultimately responsible for the report be someone who has been part of the process before.
- Periodically, share the CD&A with someone outside the drafting process to make sure the story is well communicated to the average investor.

# Execution

- Never leave the question of "why" unanswered. A compensation committee should always clearly explain why it made the compensation decisions it did.
- A table of contents with hyperlinks to certain data helps investors navigate the document. Few will read the entire proxy or CD&A, but they know what they are looking for.
- Many who read the proxy and CD&A will do so only on a computer. Make sure graphics and layout work well in both a printed and an online format.
- Compensation committees can and will use discretion. When discretion is used, explain the business reasons behind why it became necessary and how the use of discretion served investors' interests.
- When mentioning metrics used to measure performance, tell investors why those metrics are seen as value drivers for the company's performance and how they link to strategic objectives. This information may not be intuitive to those outside the company.
- Perhaps include a section on pay governance—"what we do, what we don't do."
- Does the CD&A communicate clearly how the company uses compensation to motivate performance over the short and long term?
- Decisions made in committee meetings and the reasons for them need to come across in the final CD&A story.
- Keep it simple. Avoid overengineered graphics and overlegalized language.
- Report on engagement activities with investors, whether they be brief phone calls or extensive in-person meetings. Show investors the process.
- Remove redundancies from the report. Respect everyone's time. Keep it as concise as possible.
- Be consistent in the use of graphics whenever possible. Investors may expect a graphic, chart, or table to be used each year if they find it useful. If you change something, succinctly give a good reason.

- If you have had a compensation issue or an anomaly in the past year, acknowledge it. Investors will give you credit for being forthright. Investors are likely to be wary of companies that ignore a compensation issue.
- Have the compensation committee take responsibility for the documents, and say that they do. Some companies include a brief introductory statement that is signed by or attributed to committee members.

# Appendix B: Examples of Best Practices in Executive Compensation Disclosure

The proxy statements shown here contain some of the best recent CD&A disclosures in the opinions of our CD&A working group. The sections we have singled out represent either an example of a best practice or an item we thought was a unique innovation worthy of attention. But we encourage readers to look at more than simply the pages highlighted here.

The proxy statements and CD&As here reflect the most recent proxy statement from each company as of 13 February 2015.

## AECOM Technology Corp.

Industrials—Construction & Engineering $4 billion

www.sec.gov/Archives/edgar/data/868857/000104746915000386/a2222783zdef14a.htm

- Pay and performance alignment—table and discussion (22–24)
- Active shareowner engagement (26)
- Compensation practices (27)
- Previous year NEO total direct compensation decisions (28)
- Detailed breakdown of CEO performance versus targets and pay (28–29)
- Compensation governance—process and decisions (38–39)

## Amazon.com

Consumer Discretionary—Internet & Catalog Retail $177 billion

www.sec.gov/Archives/edgar/data/1018724/000119312514137728/d658395ddef14a.htm

- Brevity of report—all that needs to be said is said in three pages (16–18)

## American Express

Financials—Consumer Finance $80 billion

www.sec.gov/Archives/edgar/data/4962/000119312514109894/d668300ddef14a.htm

- Changes in compensation program (22)
- CEO pay at a glance up-front in CD&A (22)
- Compensation governance: "what we do, what we don't do" (24)
- Overview of compensation design table—pay elements, what it does, and metrics for that year (26)
- Discussion of peer group, which includes some not in the same industry (nonfinancials) (27)
- Discussion of use of compensation consultant (28)
- Compensation committee process and timeline for setting CEO and NEO compensation (29)
- Yearly CEO performance review process—decisions made, goals set, and performance versus goals over last year (30–33)

## Apache Corp.

Energy—Oil, Gas, & Consumable Fuels $25 billion

www.sec.gov/Archives/edgar/data/6769/000119312514127066/d616560ddef14a.htm#tx616560_23

- Hyperlinked table of contents within CD&A (31)
- Key compensation and governance actions over the past year (32–33)
- Change in CEO compensation placed up-front in CD&A (33)
- Summary of engagement activities, including feedback received and board response (34)
- Summary of governance best practices (35)
- Explanation of reported pay versus realized pay (39)
- Discussion of the use of discretion in compensation decisions (41)
- Each element of compensation discussion includes decisions made in the past year concerning that element of compensation; decisions are then summarized on one page (50).
- Detailed breakdown of annual metrics and whether they were or were not met (45)

## Best Buy

Consumer Discretionary—Specialty Retail $14 billion

www.sec.gov/Archives/edgar/data/764478/000076447814000014/bbydefinitiveproxy2014.htm

- Results of last year's say-on-pay vote, engagement, and board actions (36)
- Pay governance: "what we do, what we don't do" (37)
- Key compensation decisions from previous year, preview of this year's compensation decisions (38)
- Table summarizing roles of key players in executive compensation decisions (39)
- Elements of compensation, including key characteristics, purpose, and principal actions from that year (42)
- Discussion of short-term metrics, hurdle rates, and performance (43-44)

## Chevron

Energy—Oil, Gas, & Consumable Fuels $213 billion

www.sec.gov/Archives/edgar/data/93410/000119312514138322/d660116ddef14a.htm

- Brief statement on engagement efforts over previous year (16)
- Brief message from compensation committee, including information on say-on-pay vote (21)
- Graphic showing elements of compensation (23)
- Graphic explaining incentive plan (28)
- Graphic highlighting metrics used to gauge performance and performance over past year (30)

### The Coca-Cola Company

Consumer Staples—Beverages $183 billion

www.sec.gov/Archives/edgar/data/21344/000130817914000049/lcocacola2014_def14a.htm

- Good use of graphics throughout; proxy and CD&A user friendly and readable
- Q&A format with chairman to address common shareowner questions (4–5)
- Summary of governance and compensation information up-front (8–14)
- Summary of changes to compensation programs: "what we heard, what we did" and when effective (10)
- Summary of how pay is tied to company performance (11)
- Impact of company performance on compensation—reported realizable and realized pay (14)
- "What we pay and why: elements of compensation" (52)
- Discussion of why company chooses to use options and PSUs (performance share units) (56)
- Status of all outstanding PSU awards (57)

### DeVry Education Group

Consumer Discretionary—Diversified Consumer Services $2 billion

www.sec.gov/Archives/edgar/data/730464/000119312514365956/d796224ddef14a.htm

- Throughout CD&A, a summary of many facts tells reader where to go in the CD&A for more detail.
- Shareowner outreach: "what we heard, how we responded" (19)
- Previous year's compensation decisions and actions (22–23)
- Pay for performance focus, including graphics detailing decisions and metrics used (24–25)

### EQT Corp.

Energy—Oil, Gas, & Consumable Fuels $12 billion

www.sec.gov/Archives/edgar/data/33213/000110465914017052/a14-2467_1def14a.htm

- Compensation committee highlights from previous year (39)
- Consideration of last year's say-on-pay vote (40)
- Discussion of peer group that includes a change in peer group (42)
- Insider stock ownership table shows requirement and actual ownership, which is much higher than requirement, showing management alignment with shareowners (44)
- Discussion of the use of tally sheets (45–46)

## Exelon Corp.

Utilities—Electric Utilities $29 billion

www.sec.gov/Archives/edgar/data/1109357/000119312514128137/d667742ddef14a.htm

- Executive compensation highlights in the very beginning, including changes to programs, CEO compensation, previous year's payout decisions (iv)
- Letter from compensation committee (37)
- Six compensation themes that are discussed throughout the CD&A that go beyond boilerplate language (38)
- Review of company performance (39)
- Unique one-time award because of a change in performance period, explained with graphic (43)
- Previous year's performance and how payouts were determined (43)
- Changes made in executive compensation program (46)

## Exxon Mobil Corp.

Energy—Oil, Gas, & Consumable Fuels $392 billion

www.sec.gov/Archives/edgar/data/34088/000119312514139818/d656765ddef14a.htm

- Integration of graphics to tell the story well throughout
- Hyperlinked table of contents within CD&A (23)
- Succinct summary of key components of executive compensation program (25)
- Detailed review of engagement from previous year (25–26)
- Summary of strategic business results that affect compensation (27)
- Performance versus peers on compensation-related metrics in a user-friendly graph presentation (28–29)
- Reported versus realized pay (30)
- Well-articulated discussion of unique way the company approaches pay (33–35)

## General Electric

Industrials—Industrial Conglomerates $253 billion

www.sec.gov/Archives/edgar/data/40545/000120677414000746/ge_def14a.htm

- Good use of graphics to help tell the story throughout
- Discussion of how and why realized pay differs from actual pay (iv)
- Key features of executive compensation program (iv)
- "What we do, what we don't do" concerning pay (iv)
- Summary of key considerations in setting pay (27)
- Summary of compensation policies and practices (28–30)

## The Goldman Sachs Group, Inc.

Financials—Capital Markets $85 billion

www.sec.gov/Archives/edgar/data/886982/000119312514131134/d627791ddef14a.htm

- Elements of compensation program that promote a long-term focus (29–30)
- Financial performance metrics (33)
- NEO 360 review process (33)

## The Hartford Financial Services Group

Financials—Insurance $18 billion

www.sec.gov/Archives/edgar/data/874766/000130817914000156/lhig2014_def14a.htm

- Good use of graphics to enhance readability throughout
- How the company executed its strategy in the previous year (30)
- Compensation decisions from the previous year (32)
- Shareowner engagement and say-on-pay results, including chart detailing "what we discussed with shareholders, what we did in response, why we did it" (32–33)
- Pay governance, "what we do, what we don't do" (34)
- Pay mix for CEO and other NEOs described in graphic (35)
- Financial performance metrics and individual award determination (35– 36)
- Executive benefits and perquisites (38)
- Discussion of recent changes to peer group and rationale (39–40)

## Intel Corp.

Technology—Semiconductor $163 billion

www.sec.gov/Archives/edgar/data/50863/000119312514128308/d673385ddef14a.htm

- Discussion of leadership transition and pay decisions around that event (37–38)
- Summary of previous year's say-on-pay vote, outreach to shareowners, and changes in previous year because of engagement (38–39)
- Annual incentive cash plan targets and payments, including formula behind payouts (43–44)
- Previous year's equity awards, including formula behind grant (46–48)
- Detailed description of shareowner engagement and changes to compensation program because of engagement, including the company's goal following engagement and approach to addressing shareowner concerns (48–52)

## Johnson & Johnson

Health Care—Pharmaceuticals $279 billion

www.sec.gov/Archives/edgar/data/200406/000119312514094846/d658498ddef14a.htm

- Summary of proxy highlights, including some compensation highlights on first page (1)
- Performance and compensation highlights (32–33)
- Yearly goals and performance shown in table (34)
- Shareowner outreach and compensation changes (35–36)
- Performance versus long-term (three-year) goals (38)
- Unique approach to peer group discussed (44–46)
- Use of tally sheets discussed (49)

## JP Morgan Chase

Financials—Banks $223 billion

www.sec.gov/Archives/edgar/data/19617/000001961714000321/jpm2014definitiveproxy.htm#sFBBFB26CB26BA1C8C95810149F8DD3C1

- Entire CD&A is a good example of a highly discretionary compensation plan.
- CD&A roadmap outlines and briefly summarizes CD&A discussion that follows (29).
- Pay governance (41)
- Peer group discussion, including some choices outside industry (43)
- Risk control table disclosure (44)

## Kaman Corp.

Industrials—Trading Companies & Distributors $1 billion

www.sec.gov/Archives/edgar/data/54381/000005438114000015/kamanproxy2014.htm

- No-frills proxy tells entire compensation story clearly and succinctly.
- Compensation highlights from previous year (18–19)
- Compensation philosophy and fundamental objectives of compensation program (19–20)
- How pay elements work in practice (21–24)

## Lockheed Martin Corp.

Industrials—Aerospace & Defense $62 billion

www.sec.gov/Archives/edgar/data/936468/000130817914000062/llmc2014_def14a.htm

- Corporate governance and sustainability best practices (7)
- Brief summary of engagement in past year (7)
- Changes in the compensation program over the past year (8, 41)
- Discussion of recent change to bylaws to give all shareowners the right to call a special meeting (13)
- List of governance practices the company does and does not engage in (40)
- Rationale behind those in peer group (43)
- Discussion of how goals were arrived at and performance over previous year (46–49)

## Lorillard

Consumer Staples—Tobacco $23 billion

www.sec.gov/Archives/edgar/data/1424847/000119312514130700/d667363ddef14a.htm

- Great summary of the proxy up-front; tells readers most of what they need to know
- Pay governance: "what we do, what we don't do" (24)
- Key executive compensation decisions and policies (24)
- Use of tally sheets (27)
- CEO compensation discussion and other CEO compensation arrangements (35–36)

## McDonald's

Consumer Discretionary—Restaurants $89 billion

www.sec.gov/Archives/edgar/data/63908/000119312514140308/d666434ddef14a.htm

- List of performance measures and how they influence compensation (14)
- Definitions used in CD&A (16)
- Elements of compensation (17–20)
- Changes in the past year (21)
- Compensation policies (24–25)

## Microsoft Corp.

Information Technology—Software & Services $378 billion

www.sec.gov/Archives/edgar/data/789019/000119312514376415/d694241ddef14a.htm

- Graphic showing board experience, expertise (13 and board bios)
- Concise summary of what happened in previous year (30)
- Concise explanation of compensation philosophy, process, and metrics (30–31)
- Pay governance: "what we do, what we don't do" (37)

## Mondelez International, Inc.

Consumer Staples—Food Products $61 billion

www.sec.gov/Archives/edgar/data/1103982/000119312514125049/d613688ddef14a.
htm#toc613688_31

- Short-term and long-term performance and impact on incentive awards (35)
- How the compensation committee considered shareowner advisory vote on pay (36–37)
- Compensation governance practices: "what we do, what we don't do" (38)
- Composition and purpose of peer group (41)
- Discussion of annual performance metrics and how they were applied this year (44–45)

## Monsanto Co.

Materials—Chemicals $56 billion

www.sec.gov/Archives/edgar/data/1110783/000119312514438444/d808057ddef14a.htm

- Layout of proxy is engaging and user friendly.
- Executive compensation highlights (8)
- Compensation performance metrics and rationale (9)
- Thorough explanation of director compensation and rationale (25–26)
- Executive compensation summary that includes most information investors need (47–49)

## Morgan Stanley

Financials—Capital Markets $69 billion

www.sec.gov/Archives/edgar/data/895421/000119312514121355/d683060ddef14a.htm

- Compensation governance (23)
- Strategic execution; lists strategic objectives versus achievement of each objective (27)
- CEO performance and compensation decisions (28–29)
- Elements of compensation (30)
- Framework for making compensation decisions (32–36)

## PepsiCo

Consumer Staples—Beverages $144 billion

www.sec.gov/Archives/edgar/data/77476/000119312514110415/d618133ddef14a.htm

- Proxy statement summary up-front that includes compensation issues (i–iii)
- Review of shareowner engagement (24–25)
- Beginning of CD&A summarizes philosophy, engagement, elements of compensation, pay governance, and company performance. (29–30)
- Explanation of long-term performance units and illustration of payouts at various levels of performance (35)
- Benefits and perquisites (40)
- Risk mitigation (43)

## Pfizer

Health Care—Pharmaceuticals $206 billion

www.sec.gov/Archives/edgar/data/78003/000093041314001277/c76328_def14a.htm

- Corporate governance and executive compensation summary up-front (ii)
- Many key items discussed twice, once in executive summary and again later in more detail
- Highlights and recent changes to executive compensation program (58, 66)
- Prior-year shareowner outreach (59, 67)
- Compensation practices, philosophy (60)
- Elements of compensation explained in a table (68)
- Explanation of why yearly performance metrics are used (62, 72)

## Praxair

Materials—Chemicals $36 billion

www.sec.gov/Archives/edgar/data/884905/000119312514095747/d684644ddef14a.htm#rom684644_23

- Summary of company performance (30)
- Alignment of executive compensation programs with Praxair business objectives (33)
- Elements of executive compensation showing objective of that element and key features (37)
- Previous year's performance-based variable compensation results and payout that shows metrics against which performance is measured and actual performance (39)
- Severance and change-in-control arrangements in one convenient table (45)

## Prudential Financial

Financials—Insurance $37 billion

www.sec.gov/Archives/edgar/data/1137774/000119312514114368/d664053ddef14a.htm

- Organization and presentation of proxy and CD&A is highly readable and easy to navigate.
- Business highlights and compensation highlights up-front (6–7)
- Detailed executive compensation highlights (36)
- Opportunity for shareholder feedback—inviting shareowners to communicate with board and noting that shareowners should read the CD&A as part of preparation for say-on-pay vote (37)
- How compensation decisions are made (39–40)
- Components of executive compensation program: component, key characteristics, purpose, principal actions (41–42)
- Annual incentive award section discusses award formula, use of peer group (42–44)
- Compensation decisions concerning each NEO highlighted and discussed throughout CD&A

## Quest Diagnostics

Health Care—Health Care Providers & Services $10 billion

www.sec.gov/Archives/edgar/data/1022079/000093041314001646/c76463_def14a.htm#c76463_compensation2

- Previous year's performance, highlighting company goals and performance (18, 19)
- Previous year's outcomes aligned with performance, additional compensation highlights (19–20)
- Compensation acts taken in previous year (20–21)
- Annual incentive compensation for year that details metrics used for performance evaluation and whether metrics were achieved (26–28)
- Approach to performance share awards that includes a table going back to 2005 showing all the short- and long-term payouts as a percentage of target (30–31)

### SVB Financial Group

Financials—Banks $5 billion

www.sec.gov/Archives/edgar/data/719739/000119312514086679/d670227ddef14a.htm

- Good job of telling the story with graphics throughout the CD&A
- Discussion of performance metrics (28)
- Link between pay and performance (29)
- Pay governance practices (29–30)

### The Timken Company

Industrial—Machinery $4 billion

www.sec.gov/Archives/edgar/data/98362/000119312514118651/d696237ddef14a.htm#tx696237_13

- Key compensation decisions from previous year—discussion of compensation during a challenging year and implications (21)
- Current year's compensation program updates; a significant change in the company (spinning off a unit) and the implications for compensation (22)
- CEO pay at a glance, including target total direct compensation and realizable pay (22–23)
- Short-term and long-term pay, including performance metrics (25)
- Table presentation of elements of compensation; link to program objectives, type of compensation, and key features (28)

### United Health Group

Health Care—Health Care Providers & Services $98 billion

www.sec.gov/Archives/edgar/data/731766/000104746914004091/a2219714zdef14a.htm#EC

- CD&A explains a complicated plan well.
- Executive summary (16–17)
- "What we do, what we don't do" (17)
- Use of tally sheets and wealth accumulation analysis (20)
- Context for last year's performance goals (23)

## Vulcan Materials

Materials—Construction Materials $9 billion

www.sec.gov/Archives/edgar/data/1396009/000119312514120199/d640635ddef14a.htm

- Proposal on say-on-pay vote includes review of executive compensation policies (16–17)
- Last year's compensation decisions (40)
- Detailed discussion of peer group (42–43)
- Good graphic describing key pay elements (44)
- Compensation decision process (45–46)
- Role of individual performance given that breaks down pay of each NEO (46–48)

## WW Granger Inc.

Industrials—Trading Companies & Distributors $16 billion

www.sec.gov/Archives/edgar/data/277135/000104746914002345/a2218610zdef14a.htm#17

- CD&A executive summary gives a good review of pay program in about three pages (27–30).
- Compensation best practices: "what we do, what we don't do" (30–31)
- Compensation committee addresses risk and pay. (32)
- Discussion of peer group (33–34)
- Stock ownership guidelines with retention requirements (41)

# Appendix C: CD&A Production Timeline

This production timeline is meant to be a rough guideline for those involved in the CD&A production process. The timeline lays out the CD&A production process along with actions of a company's compensation committee because many of the actions and decisions of the compensation committee will influence the story told in the CD&A. Each company's circumstances are unique, of course, so some companies may start a step earlier than other companies and some, later. This timeline is intended to give those companies interested in the production of the CD&A a good understanding of the timing of the process.

The production timeline assumes an annual meeting in May of Year 2 and a fiscal year-end of 31 December.

| **Compensation Committee Meetings/Actions** | **CD&A Production Staff Actions** |
|---|---|
| ***Year 1*** | ***Year 1*** |
| Q1:<br>■ Set metrics for CEO's and NEOs' Year 2 compensation.<br>■ Set goals, objectives for CEO's and NEOs' Year 2 compensation.<br>■ Ensure that goals and metrics align with short-term and long-term strategy.<br>■ Review feedback on compensation from shareowner engagement. | Q1: |
| Q2:<br>■ Review feedback on compensation from shareowner engagement. | Q2: |

| Compensation Committee Meetings/Actions<br>Year 1 | CD&A Production Staff Actions<br>Year 1 |
|---|---|
| Q3:<br>■ Review results from Year 1 say-on-pay votes, discuss lessons learned.<br>■ Adjust Year 2 compensation metrics, goals if engagement, strategy dictates.<br>■ Review progress of CEO and NEO performance for Year 1.<br>■ Review feedback on compensation from shareowner engagement. | Q3:<br>■ Using the Year 1 draft as a template, complete a first draft of CD&A for Year 2. It may be useful to have a first draft done before committee meeting in Q4 when final compensation decisions for the year are made.<br>■ Identify key issues to address and make updates to formatting and content. The compensation committee should also be asked what changes it wants or expects.<br>■ Begin planning, organizing for Year 2 CD&A—changes to plans, changes to policy, new disclosures. |
| Q4:<br>■ Evaluate CEO and NEO performance for Year 1.<br>■ Determine final base compensation for CEO and NEOs for Year 1.<br>■ Finalize Year 2 compensation metrics and goals accordingly if engagement and strategy dictate.<br>■ Make necessary changes to executive compensation plan for Year 2.<br>■ Review feedback on compensation from shareowner engagement. | Q4:<br>■ Prepare second draft of CD&A for Year 2 by completing some of the language for new plans, policies, and disclosures agreed on by the committee. Draft may still have many holes in it waiting for final information or decisions. |

| Compensation Committee Meetings/Actions | CD&A Production Staff Actions |
|---|---|
| **Year 2** | **Year 2** |
| Q1:<br>■ Determine bonus payout for Year 1. | Q1:<br>■ Review drafts of tables and footnotes before the compensation committee makes a decision on annual bonuses. Assuming a fiscal year-end of 31 December and assuming that final bonuses are paid in February, CD&A writers should have a fairly accurate understanding of final accounting numbers by this time.<br>■ Finalize draft of CD&A in February for board review at that time.<br>■ Incorporate edits from board into final edit for approval in March.<br>■ Work with IR or the corporate secretary to prepare for outreach to selected investors if necessary. |

# Appendix D: Item 402(b) Elements

Exhibit D.1 lists the required elements of the compensation discussion and analysis according to SEC Rule 402(b) as of February 2015.[4] The left-hand column of the exhibit lists the required data, and the right-hand column lists possible places to find the data in this model CD&A template; you will notice there is often more than one place that each required topic may be discussed.

There are a number of reasons why a required disclosure may be discussed in more than one section. For example, a company may wish to simply touch on an issue from a broad perspective in the overview section (Section I) and go into more detail in a later section. Also, in some cases, required disclosure may be legitimately addressed in more than one section. For example, a discussion concerning *(v) How the registrant determines the amount (and, where applicable, the formula) for each element to pay* may be discussed in both Section IV (Compensation Decisions) and Section V (Compensation Framework) or in only one of these sections, depending on the editorial choices of the CD&A author.

This exhibit is meant as a tool for those drafting or reading a CD&A to help ensure all required materials are covered. We encourage those drafting a CD&A not to submissively follow any checklist or order of discussion points that could compromise the intent of the CD&A to clearly communicate a company's compensation story. The working group encourages CD&A authors to use a concise and clear writing style that best communicates their company's compensation story to shareowners.

**Exhibit D.1. Required Elements of CD&A**

| Item 402(b) Elements | Where Found in Model CD&A Template |
|---|---|
| (1) Discuss the compensation awarded to, earned by, or paid to the named executive officers. The discussion shall explain all material elements of the registrant's compensation of the named executive officers. The discussion shall describe the following: | |
| (i) The objectives of the registrant's compensation programs | Section I. Overview |

(continued)

[4]See www.ecfr.gov/cgi-bin/text-idx?c=ecfr&tpl=/ecfrbrowse/Title17/17cfr229_main_02.tpl.

## Exhibit D.1. Required Elements of CD&A (continued)

| Item 402(b) Elements | Where Found in Model CD&A Template |
|---|---|
| (ii) What the compensation program is designed to reward | Section I. Overview<br>Section III. Performance Targets for Past Year<br>Section V. Compensation Framework: Compensation Policies |
| (iii) Each element of compensation | Section II. Elements of Compensation |
| (iv) Why the registrant chooses to pay each element | Section I. Overview<br>Section IV. Compensation Decisions |
| (v) How the registrant determines the amount (and, where applicable, the formula) for each element to pay | Section IV. Compensation Decisions<br>Section V. Compensation Framework: Compensation Process |
| (vi) How each compensation element and the registrant's decisions regarding that element fit into the registrant's overall compensation objectives and affect decisions regarding other elements | Section II. Elements of Compensation<br>Section V. Compensation Framework |
| (vii) Whether and, if so, how the registrant has considered the results of the most recent shareholder advisory vote on executive compensation required in determining compensation policies and decisions and, if so, how that consideration has affected the registrant's executive compensation decisions and policies | Section I. Overview<br>Section IV. Compensation Decisions |
| (2) While the material information to be disclosed under Compensation Discussion and Analysis will vary depending upon the facts and circumstances, examples of such information may include, in a given case, among other things, the following: | |
| (i) The policies for allocating between long-term and currently paid-out compensation | Section V. Compensation Framework: Compensation Policies |
| (ii) The policies for allocating between cash and noncash compensation, and among different forms of noncash compensation | Section V. Compensation Framework: Compensation Policies |
| (iii) For long-term compensation, the basis for allocating compensation to each different form of award (such as relationship of the award to the achievement of the registrant's long-term goals, management's exposure to downside equity performance risk, correlation between cost to registrant and expected benefits to the registrant) | Section IV. Compensation Decisions<br>Section III. Performance Targets for Past Year |
| (iv) How the determination is made as to when awards are granted, including awards of equity-based compensation, such as options | Section IV. Compensation Decisions<br>Section V. Compensation Framework: Compensation Process |

(continued)

## Exhibit D.1. Required Elements of CD&A (continued)

| Item 402(b) Elements | Where Found in Model CD&A Template |
|---|---|
| (v) What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions? | Section I. Overview<br>Section III. Performance Targets for Past Year |
| (vi) How specific forms of compensation are structured and implemented to reflect these items of the registrant's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal[s] or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified named executive officers or to all compensation subject to the relevant performance goal(s) | Section I. Overview<br>Section III. Performance Targets for Past Year<br>Section V. Compensation Framework: Compensation Process |
| (vii) How specific forms of compensation are structured and implemented to reflect the named executive officer's individual performance and/or individual contribution to these items of the registrant's performance, describing the elements of individual performance and/or contribution that are taken into account | Section I. Overview<br>Section II. Elements of Compensation<br>Section III. Performance Targets for Past Year<br>Section V. Compensation Framework: Compensation Process |
| (viii) Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment | Section V. Compensation Framework: Compensation Policies |
| (ix) The factors considered in decisions to increase or decrease compensation materially | Section I. Overview<br>Section III. Performance Targets for Past Year<br>Section IV. Compensation Decisions |
| (x) How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g., how gains from prior option or stock awards are considered in setting retirement benefits) | Section V. Compensation Framework: Compensation Process<br>Section VI: Employment and Termination Agreements |
| (xi) With respect to any contract, agreement, plan, or arrangement, whether written or unwritten, that provides for payment(s) at, following, or in connection with any termination or change in control, the basis for selecting particular events as triggering payment (e.g., the rationale for providing a single trigger for payment in the event of a change in control) | Section VI. Employment and Termination Agreements |

(continued)

**Exhibit D.1. Required Elements of CD&A** (continued)

| Item 402(b) Elements | Where Found in Model CD&A Template |
|---|---|
| (xii) The impact of the accounting and tax treatments of the particular form of compensation. | Section V. Compensation Framework:<br>Compensation Process<br>Compensation Policies |
| (xiii) The registrant's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership) and any registrant policies regarding hedging the economic risk of such ownership | Section V. Compensation Framework:<br>Compensation Policies |
| (xiv) Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies) | Section V. Compensation Framework:<br>Compensation Process |
| (xv) The role of executive officers in determining executive compensation | Section V. Compensation Framework:<br>Compensation Process |
| *Instructions to Item 402(b).* | |
| 1. The purpose of the Compensation Discussion and Analysis is to provide to investors material information that is necessary to an understanding of the registrant's compensation policies and decisions regarding the named executive officers. | |
| 2. The Compensation Discussion and Analysis should be of the information contained in the tables and otherwise disclosed pursuant to this Item. The Compensation Discussion and Analysis should also cover actions regarding executive compensation that were taken after the registrant's last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided. | Section I. Overview<br>Section IV. Compensation Decisions |
| 3. The Compensation Discussion and Analysis should focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions. The Compensation Discussion and Analysis shall reflect the individual circumstances of the registrant and shall avoid boilerplate language and repetition of the more detailed information set forth in the tables and narrative disclosures that follow. | Section I. Overview |

(continued)

## Exhibit D.1. Required Elements of CD&A (continued)

| Item 402(b) Elements | Where Found in Model CD&A Template |
|---|---|
| 4. Registrants are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant. The standard to use when determining whether disclosure would cause competitive harm for the registrant is the same standard that would apply when a registrant requests confidential treatment of confidential trade secrets or confidential commercial or financial information pursuant to Securities Act Rule 406 (17 CFR 230.406) and Exchange Act Rule 24b-2 (17 CFR 240.24b-2), each of which incorporates the criteria for nondisclosure when relying upon Exemption 4 of the Freedom of Information Act (5 U.S.C. 552(b)(4)) and Rule 80(b)(4) (17 CFR 200.80(b)(4)) thereunder. A registrant is not required to seek confidential treatment under the procedures in Securities Act Rule 406 and Exchange Act Rule 24b-2 if it determines that the disclosure would cause competitive harm in reliance on this instruction; however, in that case, the registrant must discuss how difficult it will be for the executive, or how likely it will be for the registrant, to achieve the undisclosed target levels or other factors. | Section III. Performance Targets for Past Year |
| 5. Disclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G (17 CFR 244.100–102) and Item 10(e) (§229.10(e)); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements. | Section III. Performance Targets for Past Year |

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