

Tips for a Plain English CD&A

Lois Yurow
Investor Communications Services, LLC
(908) 518-0237 (v)
(908) 518-0247 (f)
lois@securitieseditor.com
www.securitieseditor.com

There are three reasons public companies should use plain English for their executive compensation disclosure (in fact, for all of their disclosure!):

- ◆ First and foremost, the SEC requires plain English for some of that information.
- ◆ Investors expect, need, and deserve plain English.
- ◆ Using plain English will improve your document and make your company look better.

If you want to communicate, and not just offer up facts for experts and the intrepid to decipher, you need to adopt a whole new approach to presenting information. Treat the CD&A requirement as a great opportunity to elevate your company's disclosure style, and resist the urge to simply update the numbers and the details from last year's filing (unless you got fabulous feedback). Many of the proxy statements filed under the rules so far need to be restructured and rewritten—ruthlessly. Even the best will need a regular housecleaning to keep them from getting bloated and stale.

The trick to creating a plain English CD&A, or any plain English document, is to be methodical. Do not expect that your first draft will be perfect, or that you will be able to fix all the problems in an existing document with one edit. I have broken the process into 22 steps, divided in five phases:

1. before you start
2. first pass
3. second pass
4. third pass
5. once you finish.

This seems like a lot, but you will be more productive if you limit the number of things you look for in each reading.

You will find short focused examples throughout this discussion to illustrate my points, and some longer “don't let this happen to you” examples at the end of the package.

Before you start

Don't procrastinate.

Many people think plain English is easier and faster to write than your average legalese, boilerplate, and gobbledygook. That may be true when you are updating a document that is already well-written and contains all the pieces of information you will need, but it certainly is not true if you are starting from scratch. It takes time and concentrated attention to identify, collect, and organize useful information and present it in a way that makes sense. And don't forget, whatever you produce will go through extensive review by colleagues and lawyers, and several negotiated drafts.

It is never too early to start working on the CD&A. If the numbers aren't ready, tackle the paragraphs that describe your company's compensation plans and philosophy and other things that won't change dramatically. It will be easier to plug in the financial information if you already have a good starting point.

Pretend that providing disclosure in plain English is a good idea, even if you don't think it is.

People who write disclosure documents (or who pay others to write them) often assume that investors do not want to read them anyway. A writer with that attitude strives for nothing more than the floor of legal compliance. Start with the premise that investors would love to have the information you are required to give them, and are intelligent enough to understand at least some of it, if only you would make it convenient to read. Focus on the quality of your disclosure; don't settle for "legally adequate."

First pass

Speak the right language.

One of the best compliments a client has given me was not intended to be a compliment. A financial officer told me that the way I explained a particular accounting concept in a 10-K was substantively correct, but that an accountant reading my explanation might not recognize it as an accounting concept at all. Great! Unless all of your investors are accountants (or compensation consultants in this case), your documents should not use

accountants' (or consultants') unique vocabulary. You want to use common words—not businesspeak, industry jargon, and legalese.

Example

Original:

ABC's compensation program is intended to create competitive advantage through the stimulation of superior performance of the Company's human capital.

Better:

ABC's compensation program is designed to motivate employees and inspire great work.

Use plenty of descriptive headers to provide a roadmap of the discussion to follow.

Good headers will help you organize information and help readers find what they want. For that reason (among others), restrict text in each section to what the header says will be there. Do not explain how you calculated annual bonuses under the heading "Compensation Philosophy."

Here are some good headers:

How We Benchmark Pay for Named Executive Officers.

Factors Considered in Setting Senior Executive Officer Compensation.

Role of Executive Officers in Compensation Decisions.

Give some context and set up the discussion.

If you plan to cover several categories of information, explain that at the beginning of the CD&A. Then every section should have a header and an introductory paragraph that explains what the section will discuss. Every paragraph should have either an introductory sentence or a sentence that eases the transition from the preceding paragraph.

Here is a good introduction:

During 2006, senior executive compensation consisted primarily of three key components: base salary, short-term cash incentive compensation, and long-term equity-based incentive compensation. We also provide various benefits to senior executive

officers, including insurance; retirement plans; termination, severance, and change-in-control arrangements; and perquisites. The sections below discuss each of these components of senior executive officer compensation, the reasons for awarding such types of compensation, the considerations in setting the amounts of each component of compensation, and the amounts actually awarded.

Use defined terms correctly.

I have seen proxy statements that refer to three different Board committees as “the Committee.” It is better to use more words and refer to the Governance Committee, the Compensation Committee, and the Audit Committee.

Similarly, many writers assign a defined term (such as the “Incentive Plan”) to every special word or long phrase they introduce, thinking they will use the term several times. Unfortunately, it is not unusual for a defined term to appear once in a long document, never to be seen again. This frustrates readers who try to learn vocabulary that supposedly will be useful. (It also suggests that no one proofread the document before it was distributed.) If you don’t need a defined term at least three times, strike it. Conversely, if you intend to use an unfamiliar term several times, explain it clearly the first time it comes up. Make your explanation obvious (indented, set off in a box, or in a distinctive font or color) so readers can find it again easily.

Personalize it.

Use your company’s name rather than “the Company” or “the Corporation,” especially if the company name is short. Some companies use personal pronouns (“We have designed our compensation program...”), but others are squeamish about that style.

If you must refer to your company in the third person, pick a term and stick with it. Don’t be “the Company” in one paragraph, and “ABC Inc.” or “the Corporation” in the next.

Don’t include unnecessary detail and superfluous material.

In two speeches discussing CD&As, SEC Chairman Christopher Cox chided companies for their “slavish adherence to boilerplate disclosure.” But he also offered a note of

encouragement that you should seize upon: “[T]here’s no reason for a company to ‘match up’ its disclosure to that of its peers or competitors. Every company has a chance to start with a clean slate.” In other words, don’t assume your company must discuss everything that your top competitors discuss. It may not be relevant to you. In fact, it may not even be relevant to your competitors, and you don’t need to copy their mistake!

On a smaller scale, some CD&As are filled with things that didn’t need to be said.

Examples

This general industry and Peer Group data is gathered by the Consultant and presented to the Corporation in reports that provide an assessment and comparative analysis of executive officer compensation to this competitive market compensation. The Consultant works in collaboration with the Corporation’s compensation department when preparing such reports. *[Since the reports relate to compensation, readers can assume that the company’s compensation department was involved. And anyway, do they care?]*

The Company’s executive compensation program is administered by the Compensation and the Stock Option Committee as an established committee of the Board. *[What else would the Compensation and Stock Option Committee be?]*

The Bank offers a 401(k) Retirement Plan to eligible employees for the purpose of helping them save for retirement. *[What else would a retirement plan be for?]*

Similarly, don’t belabor the obvious. Distinguish critical data from the unimportant details that can be omitted.

Example

Original:

Annual performance goals for the XXXX Plan are generally developed, initially, by ABC Co., an independent consulting firm with expertise in EVA-based incentive programs. The firm’s recommended performance goals are reviewed by the committee. The committee approves the goals with any changes the committee determines appropriate. *[Does your reader really need to know this much about each step in the process?]*

Better:

Annual performance goals for the XXXX Plan generally are developed by ABC Co., an independent consulting firm with expertise in EVA-based incentive programs, and then finalized by the committee.

Prefer the active voice.

Using the active voice rather than passive voice is helpful for two reasons: it will be obvious who did what; and your sentences likely will be shorter.

Example

Original:

This general industry and Peer Group data is gathered by the Consultant and presented to the Corporation in reports that provide an assessment and comparative analysis of executive officer compensation to this competitive market compensation.

Better:

The Consultant gathers this general industry and Peer Group data and uses it to compile reports that assess executive officer compensation and compare that compensation to the relevant market.

Include charts and tables, but use them instead of—not in addition to—information that would otherwise be in the text.

When you have a lot of data to provide, it is often easier to plug it into a chart or table. Graphics are convenient for readers because they offer a snapshot view of several facts at once. If you have created a good graphic, trust it. Use your text to explain the information, not to repeat it.

Say everything just once, in an unambiguous way, under a logical header.

If an idea or policy statement applies to several elements of compensation, explain it once in an introductory paragraph, not once under “base salary,” and again under each of “long-term incentive awards,” “annual bonuses,” and “equity option awards.” There is some completely unnecessary repetition in the CD&As filed thus far. For example, one company, for every form of compensation, offered some version of this long statement:

“The Compensation Committee considers many factors in our determination of . . . compensation levels, using our competitive benchmarks as a starting point. The executive’s overall performance, his or her potential, and the presence of any unique or hard-to-replace skills are considered, as well as the executive’s judgment, leadership ability and competencies. The performance of the executive’s business function and his or her ability to build teams and develop talent are also factors. In addition, the overall performance of the Company must be weighed, especially in the case of the Named Executive Officers and other senior leaders.” Another company explained several times that the compensation committee makes decisions about different compensation elements during different quarters so that executives are evaluated frequently.

If you are saying the same thing several times, you are wasting your reader’s time—and your own.

Second pass

Replace word strings and sentence strings with bullet lists.

There are three good reasons to look for opportunities to replace text with bullet lists:

- ◆ Bullets usually only require a few words, and there will be space between each item, so your document will be easier on the eye;
- ◆ Each point will stand out; and
- ◆ You can usually eliminate words.

There are several uses for bullet lists, but they are particularly good substitutes for word strings and sentence strings. I use the term “word string” to refer to a sentence that lists several items separated by commas or semicolons.

Example

Original with word string:

ABC delivers long-term incentive opportunities that encourage ownership. Specifically, ABC grants stock settled stock appreciation rights (“SARs”), incentive stock options (“ISOs”), nonqualified stock options (“NQOs”) and/or restricted stock/restricted stock units, in addition to long-term performance cash incentives.

Better:

ABC delivers long-term incentive opportunities that encourage ownership, including:

- Stock settled stock appreciation rights (“SARs”);
- Incentive stock options (“ISOs”);
- Nonqualified stock options (“NQOs”) and/or restricted stock/restricted stock units;
and
- Long-term performance cash incentives.

You usually create “sentence strings” when you are describing a multi-step process. You probably won’t realize until you finish writing that you have started every sentence with the same three words.

Example

Original with sentence string:

The Committee xxxxx. The Committee also xxxxxxxx. Then, in consultation with the CEO, the Committee xxxxxxxx. After reviewing the Company’s year-end results, the Committee xxxxxxx.

Better:

The Committee has adopted the following multi-step process for determining incentive compensation awards:

- xxx
- xxx
- xxx
- xxx

Once you have your bullet lists, make sure the language is consistent. Don’t start one bullet with a verb and the next with a noun.

Example

Original:

The Company uses the following general principles to guide its decisions regarding the design of its compensation program and to ensure that it is consistent with the overall objectives described above:

1. Provide a competitive compensation package.
2. The Company's compensation program should align the interests of Named Executive Officers with the interests of the Company and its shareholders.
3. A significant portion of the compensation package should be tied to performance of the Company.

Better:

The Company uses the following general principles to guide its decisions regarding the design of the compensation program and to ensure that the program is consistent with the overall objectives described above. The compensation program should:

1. Be competitive.
2. Align the interests of Named Executive Officers with the interests of the Company and its shareholders.
3. Be tied, to a significant extent, to the Company's performance.

Make sure your explanation follows a logical sequence.

Think carefully about what readers need to know, and in what order. If Compensation Plan A draws all of its objectives and formulas from Compensation Plan B, by all means—explain Plan B first! Your discussion will be much more useful, and you likely can eliminate cross-references and repetition to make it shorter.

Here is a paragraph that is completely out of order. Once I rearranged the sentences, it was easy to see that the company was repeating itself. I was able to eliminate over half of the words.

Example

Original:

The Plan places a portion of incentive compensation at risk, since participants must achieve certain performance thresholds to earn bonus incentive compensation under the Plan. In addition, the Plan increases bonus incentive awards when performance exceeds Plan objectives. Under the Plan, participants are eligible to earn cash bonus incentive compensation based upon the achievement of certain performance goals and objectives relating to the Company and each individual participant. The Committee establishes quarterly and annual performance goals and objectives for the Plan. Following the end of each performance period, the Committee determines the extent to which the performance goals and objectives were obtained. Based on this assessment, eligible participants in the Plan may earn a bonus incentive award in an amount equal to a percentage of such participant's target bonus incentive compensation. [131 words]

[Doesn't the first underlined sentence look like it should come after the sentence that follows it? Point A: participants can earn a bonus if we achieve our goals. Point B: participants can earn a better bonus if we exceed our goals. As for the second underlined sentence, how helpful is it to give the reader an unknown percentage of an unknown target amount?]

Better:

Since Plan participants must achieve certain performance thresholds to earn bonus incentive compensation, a portion of their compensation is at risk. The Committee establishes and monitors quarterly and annual performance goals and objectives for the Plan. Participants are eligible to earn cash bonus incentive compensation based on whether, and by how much, individual and company-wide performance goals and objectives are achieved or surpassed. [63 words]

Make sure each piece of information is easy to find.

Your headers are snappy and descriptive. Your opening sentences tell the reader where you are going. Don't let it all fall apart in the meat of your discussion by trying to pack too much information into a single sentence.

Example

Original:

Base salary is set with the goal of attracting executives and adequately compensating and rewarding them on a day-to-day basis for the time spent and the services they perform and skills and experience they bring to the Company, while our equity incentives are geared toward providing an incentive and reward for the achievement of long-term business objectives and retaining key talent.

[This sentence is too wordy and too long. The reader will lose focus before finding out how equity incentives are used.]

Better:

Base salary is designed to attract executives and adequately compensate them for their time, services, skills, and experience. Equity incentives are designed to retain key talent, motivate executives to achieve long-term business objectives, and reward executives when those goals are attained.

Eliminate ambiguity.

Read your document critically. If it contains a lot of hedge words and vague language, readers may think the drafter either did not understand what the company wanted to say, did not know how to say it clearly, or intentionally avoided making an unequivocal statement.

Most of the time, the problem is lack of knowledge. The solution is to find someone who thoroughly understands the issue, and ask plenty of questions. Then translate what you learned into a logical, orderly explanation that gives readers specific, useful information—including any background or definitions they may need.

If you are working with language that is intentionally ambiguous, find out why and see if there is a legal and responsible way to be more forthright. Face it: If your words are susceptible to more than one meaning, readers will select the one that is the least favorable to your company (unless they sue, and then they will argue that they believed the “best case” interpretation). If your words are too vague to be interpreted at all, readers will be justifiably annoyed.

Anticipate—and answer—questions.

I recently worked on a CD&A for a company with two incentive plans. The company’s working draft explained that one plan was for the five named executive officers, but did not explain who was covered by the second plan. Similarly, the working draft did not explain why the company had two distinct plans for the same basic purpose. Lapses like that raise unnecessary questions.

If your CD&A is truly in plain English, investors will walk away from it with a basic understanding of the elements of your company’s compensation program, what each of those elements is designed to reward or motivate, how the company determines the amount to be paid for each element, and why the Board selected this mix of elements. If you aren’t answering these questions, you have more work to do.

Edit out the word “respectively.”

You can ease your reader’s memory load dramatically by avoiding the word “respectively.” Consider which of the following sentences is easier to track.

Example

Ms. Baker received salary, bonus, and deferred compensation in the amounts of \$1.1 million, \$3.1 million, and \$1.4 million, respectively.

OR

Ms. Baker received a salary of \$1.1 million, a bonus of \$3.1 million, and deferred compensation of \$1.4 million.

Adjust your layout.

A plain English document uses white space, decent margins, and short focused paragraphs. Our eyes and our brains need visual interest and regular breaks.

Print out your draft CD&A and just flip through the pages. Does it look like something you would want to read, or is it intimidating? Here are some things to consider:

- ◆ If you have blocks of right-justified text, convert your document to “align left,” which will give you a solid left margin but a jagged right margin (like this paper).

- ◆ If you have a paragraph that runs more than half a page, try to break it into two smaller paragraphs, or see if there is text that can be converted into a bullet list.
- ◆ If the descriptive headers you wrote are not jumping off the page, play with the font (make it larger or darker) and the placement (increase the white space above and below).
- ◆ If you consistently have more than 15 or 20 words across a single line of text, consider enlarging your font or your side margins.

You may end up with a longer document than you started with, but your readers will appreciate it.

Third pass

Eliminate extraneous words.

Your CD&A should be in pretty good shape by now. As you read it cover to cover (yes, again!), keep looking for ways to clean it up. Chances are you will find thoughts or whole sentences that appear more than once—especially if different people wrote different sections. You will certainly find words or phrases that were written in the haste to create a working draft that really don't need to be there.

Examples

~~In keeping with the Committee's performance-based philosophy,~~ the Committee believes that long term incentives should be closely tied to creation of shareholder value. *[You have probably already given your performance-based philosophy enough attention.]*

The Committee determines the final compensation for our Chief Executive Officer and other named executive officers, although ~~with respect to the other named executive officers,~~ the Chief Executive Officer works closely with the Committee to make recommendations ~~to the Committee~~ regarding the named executive officers' compensation. *[Phrases like "with respect to" and "in connection with" can usually be deleted.]*

The Committee may award special bonuses to executive officers based on a number of factors, including extraordinary performance, market demands or other factors. *[The underlined words are too general to be informative.]*

Make sure your language is consistent throughout.

Do not switch back and forth between first person (“We offer our executives....”) and third person (“The Company provides each executive....”). You also should not switch between a conversational tone and a formal or legal tone. If you need to quote directly from a legal document, make it clear that you are quoting. If you don’t need a direct quote, then paraphrase—but in plain English.

Example

The Compensation and Stock Option Committee meets each June to determine which employees, if any, should receive grants of stock options. In addition to the employee-specific issues described in the previous paragraph, the Committee reviews the following items when considering the granting of employee stock options: [text omitted]. It is the policy of this Committee that neither the Committee nor any member of management shall backdate any equity grant, or manipulate the timing of the public release of material information or of any equity award with the intent of benefiting the grantee. Accordingly, management shall advise the Committee whenever it is aware that material non-public information is planned to be released in close proximity to the normal date for the grant of an equity-based compensation award. *[The first two sentences are conversational. The two underlined sentences were clearly written by a lawyer and do not match the tone of the rest of the paragraph.]*

Edit to conform to grammar rules, even the ones you don’t like.

Once you put all that work into drafting your CD&A, it would be a shame for a stickler like me to think you are sloppy because you failed to notice and correct a grammatical error. Here are some common problems.

Examples

At present, the executive compensation program is comprised of base salary, annual cash incentive compensation and long-term incentive compensation in the form of stock options. [*“is comprised of” is never correct. The word “comprise” means “embrace,” so you need to say “the compensation program comprises base salary....” If “comprises” sounds weird to you, substitute “consists of.”*]

At year-end, if it is determined that by making the appropriate incentive plan payout to the executive team it would cause the Bank to fall short of its desired earnings goal, then the incentive plan pool is adjusted downward. [*The two underlined phrases should agree, and they don't. The easy fix is to delete the words “by” and “it,” resulting in this: “...that making the appropriate incentive plan payout to the executive team would cause the Bank....”*]

Each year the Bank's Board of Directors determines on a subjective basis after reviewing all the elements set forth in the CD&A the amount of Bank stock or cash to contribute to the Plan for the participants (if cash is contributed, the trustee is instructed to purchase shares in the open market). [*If you put a full sentence in parenthesis, treat it like a real sentence, thus: “...for the participants. (If cash . . . open market.)”*]

Once you finish

Get an outside opinion—perhaps two or three.

Ask someone from outside the company (preferably not one of your attorneys) to critique your CD&A (but be careful about disclosing material non-public information). You may think that everything is clear and unambiguous because you know the company's history, the industry vocabulary, and the nuances of your compensation plans. An outsider can read a passage and give you a logical interpretation that may be absolutely wrong, ask questions that show you where the holes are in your story, and point out sentences that the average person would need to read three or four times to comprehend. It is always an unexpected revelation for my clients when I highlight things that company officers think are perfectly plain but that actually are unintelligible to an outsider.

After you revise the CD&A based on the outsider's comments about content and clarity, give the document to a second person (and even a third) for basic proofreading. Ask the proofreader to look for:

- ◆ Extraneous words (these may occur when you write, or you may have forgotten to delete something when you edited);
- ◆ Real words (so they won't jump out at you as errors) that aren't the right word (say, "condensation" rather than "compensation");
- ◆ Repetition ("Also, the Committee also....");
- ◆ Sentences that are too long and should be broken into two or three;
- ◆ Inconsistent usage (you refer to "the Company" in one paragraph and "the Corporation" in the next);
- ◆ Awkward transitions between paragraphs that could be fixed by adding subheaders or better opening sentences;
- ◆ Incorrect cross references (for example, you changed the name of a header, but didn't change an internal cross-reference to that section); and
- ◆ Unnecessary defined terms.

These longer examples will tie together many of tips you just read.

Original

A recommendation for the target total compensation of the Corporation's other executive officers, including the CFO and other NEOs, is made by the CEO after reviewing the executive's and the Corporation's performance in conjunction with the executive's responsibility and experience when compared to the competitive information prepared by the Consultant. The compensation package for the other executive officers, including the CFO and the other NEOs, is established by the Committee based on the recommendation of the CEO to the Committee and in consideration of the executive officer's individual responsibility and experience and overall performance.

Major Problems:

- ◆ Uses passive voice rather than active voice.
- ◆ Contains long, awkward, repetitive sentences.

Solutions:

- ◆ Convert passive voice to active voice.
- ◆ Eliminate repetition.
- ◆ Clean up language.

Better

The CEO reviews the performance of each executive officer and of the Corporation, and considers that performance in relation to each executive's responsibility and experience and the competitive information prepared by the Consultant. Based on that review, the CEO makes a recommendation regarding the target total compensation of the other executive officers, including the CFO and other NEOs. The Committee uses that recommendation and the information supporting it to establish compensation packages.

[The underlined language could probably be deleted. I assume the CFO and other NEOs are executive officers.]

Original

Bonus Incentive Compensation

In January 2006, the Committee reviewed and approved the business objectives and target cash compensation of our executive officers for 2006. The Committee determined that the primary business objective for 2006 was to achieve the new product revenue target in our annual operating plan. Growth in this portion of the business was an important objective due to the strategic importance of these products and the markets they serve and due to the impact that the announced end-of-life of our XXXX and ZZZZ products was expected to have on Company revenue. The Committee also decided that achieving the total Company revenue and non-GAAP operating income in our annual operating plan were also key business objectives for 2006, in order to maximize Company revenue during the transition from our XXXX and ZZZZ business, and in order to achieve non-GAAP profitability in 2006.

The Committee established that fifty percent of each participant's target bonus incentive compensation for 2006 would be based upon the Company's achievement of the new product revenue included in the annual operating plan (the "Plan Revenue Objective"), and fifty percent of each participant's target bonus incentive compensation was dependent upon the Company's achievement of a non-GAAP operating income goal (the "Plan Financial Objective"). The Company had to achieve a certain threshold for participants to earn bonus incentive compensation against the Plan Revenue Objective, and the Company had to achieve a certain threshold for participants to earn bonus incentive compensation against the Plan Financial Objective. Quarterly bonus incentives awarded were adjusted for the level of the Company's performance during the quarter in question, and could, if the threshold level of performance is achieved, range from 80% to 100% of the quarterly target bonus amounts. Annually bonus incentive compensation was adjusted for the level of the Company's achievement, and could range from 80% to 200% or more of the target bonus incentive compensation. During 2006, the Chief Executive Officer's target bonus incentive compensation was 21% of his annual salary compensation and each of the other Named Executive Officers had a target bonus incentive compensation equal to 13% to 23% of their annual salary compensation, except

that Ms. Smith, who was promoted to an executive position during the fourth quarter of 2006, did not have a bonus component to her incentive compensation until January 2007.

Major problems:

- ◆ The first paragraph takes too long to convey three business objectives. The second paragraph is just too long.
- ◆ The editing is sloppy (“The Committee *also* decided . . . were *also* key. . .” and “dependent upon the Company’s achievement. . .”). In general, there are too many words.
- ◆ The Committee has established three “key” business objectives, but only uses two of them as a basis for incentive compensation. An investor might ask why they disregarded the third objective. (My revised draft does not solve this problem since I would need to ask the company some questions.)
- ◆ It is hard to determine whether the Company must achieve the revenue goals before executives can earn a bonus or whether bonuses can start to accrue when the Company hits a threshold revenue level. (This also requires clarification from someone who understands the compensation program, but I took a stab at it.)

Solutions:

- ◆ Use a numbered list to isolate the business objectives.
- ◆ Clean up the language.
- ◆ Clarify the incentive compensation prerequisites.

Better

Bonus Incentive Compensation

The Committee determined that the primary business objectives for 2006 were achieving three targets in the annual operating plan:

1. New product revenue;
2. Total Company revenue; and
3. Non-GAAP operating income.

Growth in the new products portion of the business was strategically important because the expected phase-out of the Company's XXXX and ZZZZ products will have an adverse impact on revenue. For the same reason, the Company must achieve the revenue and operating income targets to be profitable (on a non-GAAP basis) for the year.

The Committee determined that 50% of each participant's target bonus incentive compensation for 2006 would depend on the Company's progress toward the new product revenue goal, and the other 50% would depend on the Company's progress toward the non-GAAP operating income goal. If the Company achieved prescribed thresholds for either goal, participants could earn bonus incentive compensation for that success. Quarterly bonus incentive awards could range from 80% to 100% of the quarterly target bonus amounts, while annual bonus incentive awards could exceed 200% of the target bonus amounts.

During 2006, the Chief Executive Officer's target bonus incentive compensation was 21% of his annual salary. Each of the other Named Executive Officers (other than Ms. Smith) had a target for bonus incentive compensation equal to 13% to 23% of their annual salary. Ms. Smith, who was promoted to an executive position during the fourth quarter of 2006, did not have a bonus component to her incentive compensation until January 2007.

Original

Performance Metrics

Selecting the appropriate performance metrics is another important element of ABC's pay for performance philosophy. Annually, we analyze the relationship of the performance measures and the weighting used in the annual and long-term incentive plans to enhance shareholder value. Since 2004, the performance metrics in both plans have been earnings per share (EPS), return on equity (ROE) and economic profit added (EPA). Each of these metrics has different benefits. Earning per share measures profitability per share and EPS Growth is easily comparable to peers and commonly used by investment analysts to communicate expectations of performance. Return on Equity measures profitability relative to capital used to generate earnings and is also easily compared to peers. Economic Profit Added measures profit generated in excess of the cost of capital and is designed to balance growth and returns and focus ABC's executive officers on the allocation of finite capital. ABC's external compensation consultants have performed regression analyses on each of the performance metrics with measures of value such as total return to shareholders and market-to-book multiples. Each metric is looked at in isolation and in combination. The consultants have confirmed that the metrics provide a strong line of sight to corporate financial performance, correlate well to value creation, and are important to the investment community. Their findings are reviewed with the compensation committee for concurrence and approval. We have selected these factors to drive improved shareholder return and enterprise value to total capital utilization and maintain consistency year over year in performance metrics for ABC employees.

Major problems:

- ◆ Long, daunting block of text.
- ◆ The paragraph is about performance metrics, but information about those metrics is buried.

Solutions:

- ◆ Break up paragraph to add white space.
- ◆ Isolate important details to make them easy to find.

Better

Performance Metrics

Implementing ABC's pay for performance philosophy requires appropriate performance metrics. Since 2004, the performance metrics used for ABC's annual and long-term incentive plans have been earnings per share (EPS), return on equity (ROE), and economic profit added (EPA). Using the same metrics for several years in a row gives ABC employees consistent standards, but the Compensation Committee analyzes these measures and their weightings regularly to ensure they remain apt.

As described below, each of these metrics offers a different benefit, and as a group they drive improved shareholder return and foster maximum value for ABC's assets.

- EPS measures profitability per share. EPS growth is an easy measure to compare among peers, and the metric is commonly used by investment analysts to communicate expectations of performance.
- ROE measures profitability relative to capital used to generate earnings. This measure also is easy to compare among peers.
- EPA measures profit generated in excess of the cost of capital. Using this metric encourages executive officers to allocate assets to uses most likely to produce growth and returns.

ABC's external compensation consultants have studied these performance metrics to determine how important they are—both alone and in combination—to ABC's mission of creating value for its shareholders. The consultants have confirmed to the Compensation Committee that EPS, ROE, and EPA are strong indicators of corporate financial performance, demonstrate value creation, and are important to the investment community.