CAPflash
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How Companies Handle Independence Issues

■ By **Margaret Engel**

The initiatives discussed above in "Independence Standards for Compensation Consultants " will likely result in a higher standard of independence for compensation consultants. None of the proposals, however, attempts to define these standards, leaving that job to the SEC. Compensation Advisory Partners researched current disclosure practices in Fortune 25 companies to understand how companies are addressing this issue in the absence of regulatory guidance.

We found that 20 out of 25 companies (80%) retained the services of an executive compensation advisory firm in 2008. The large multi-service human resource consulting firms dominated, with either Towers Perrin, Mercer or Watson Wyatt providing services to 12 of the 20 companies (60%). The remaining eight companies (40%) retained smaller boutique firms that are unlikely to provide other services, including Pearl Meyer & Partners, Frederick W. Cook, Total Reward Strategies LLC, Compensation Strategies LL, ExeQuity and icca .

Two of the 20 companies (10%) reported changing advisors, but a trend toward the boutique firms was not apparent. Chevron replaced Hewitt, a multi-service firm, with ExeQuity, but Unitedhealth Group moved in the other direction, replacing Semler-Brossy, a boutique, with Towers Perrin, a multi-service firm.

Seventeen of the 20 companies (85%) indicated that their executive compensation advisory firm was independent. Three companies (15%) did not address this issue in their disclosures.

Nine of the 20 companies (45%) defined an independent compensation consultant as a firm that did not do any other work for the company. One company (5%) applied this standard to the individual adviser, rather than the firm, noting that the individual consultant did no other work for the company. Seven of the 20 companies (35%) maintained that their compensation consultant was independent, while allowing the consulting firm to provide other services. Several noted that the extent of these services were modest or immaterial. In some cases, the Compensation Committee required advance approval of other services. In other cases, Committee approval was not required specifically.

Several companies added their own unique provisions to their definition of independence. Some examples include:

- Requiring that the consulting firm annually attest to compliance with the stipulation to do no other work;
- Rotating the consultant after five years, and prohibiting the Company from hiring any consulting firm staff involved with the account for one year;
- Requiring that the individual consultant not be involved in other work, prohibiting sharing of information on compensation with other staff of the consulting firm, and requiring that the consultant's compensation not depend on cross-selling other services;
- Limiting payments to affiliates of the consulting firm to two percent of aggregate gross revenues of the consulting firm and its affiliates;
- Prohibiting the consulting firm from providing services directly to senior officers of the Company.

Two companies embraced the concept of enhanced disclosure. Home Depot disclosed fees paid to both its consulting firm and to an affiliate of its consulting firm that provides other services related to the retirement plan. Another company committed to disclose aggregate fees by category of service if it determined that its consultant was not independent. In this case, the consulting firm would not be deemed independent if it or its affiliates provide other services that exceed two percent of gross revenues; or if individuals serving the Compensation Committee provide other services not at direction and under supervision of the Committee. A third approach we have seen used outside of the Fortune 25 population is to publish the ratio of executive compensation consulting fees to fees for other services, with the consulting firm deemed independent provided fees for other services are less than compensation consulting fees.

In summary, the majority of companies are now defining independence strictly to prohibit the firm and the individual

1120 avenue of the americas, new york, ny 10036 | phone: (212) 921-9350 | fax: (212) 626-6537 | capartners.com

consultant from doing other work for the company. A minority of Compensation Committees allow their consultants to perform other work, but require Committee approval and/or a materiality threshold.

Assuming the SEC is ultimately called to develop standards for consultant independence, what approach will they take? If the SEC requires consulting firms to do no other work, the SEC will limit the ability of the large multi-service consulting firms to compete in the marketplace. On the other hand, if the SEC imposes less rigorous standards, it may be in the awkward position of espousing a set of standards that are less comprehensive than in place currently at the majority of large companies.We expect the SEC to modify these disclosure rules to respond to the requirement for "competitively neutral" regulations embedded in H.R. 3269. The SEC's proposed rules are not competitively neutral since fee disclosure would apply only if additional services were provided. This confers a major advantage on boutique firms that do not provide additional services, since they would be exempt from the disclosure requirements. The attention of regulatory and legislative bodies on this issue will certainly continue. As we point out below ("How Companies Handle Independence Issues") some companies are already initiating their own independence standards for compensation consultants.

Please contact us at (212)-921-9350 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at www.capartners.com ***for more information on executive compensation.***