

Compensation Consultant Conflicts in the Spotlight in 2010

The Securities and Exchange Commission has proposed significant changes to its proxy disclosure rules that will provide greater insight into the independence and objectivity of the compensation consultants providing advice to board compensation committees. Specifically, the SEC is considering rules that will require companies to:

- disclose all of the fees paid to compensation consultants and their affiliates when they play any role in determining or recommending the amount or form of executive or director compensation, if they also provide any other services to the company or its affiliates; and
- describe the additional services provided to the company by the compensation consultant and its affiliates.

In addition, Congress is currently considering legislation that would bolster the existing independence requirements for board compensation committee members, as well as impose specific independence standards for compensation consultants and other similar advisors.

These developments are not unexpected. For years, to counter the perception that board compensation committees and their advisors are subject to the undue influence of company management (particularly the CEO), institutional investors have actively campaigned for companies to engage independent compensation consultants who are hired by and who report directly to the board compensation committee and who are not retained by the company in any other capacity. In the current environment, it is virtually assured that the relationships of executive compensation consultants with the companies of the boards of directors they advise will be in the spotlight during the 2010 proxy season.

Accordingly, we expect board compensation committees to be more sensitive to the issue of advisor independence and more vigilant in avoiding even the appearance of a potential conflict of interest on the part of their advisors. Where an advisor provides additional services to the company, or any

of its affiliates, it is imperative that, as an initial matter, the board compensation committee understand fully the type and cost of these additional services. Only then can the committee make an informed decision about the advisor's independence and the external perception of its broader commercial relationship with the company. In an environment where perception is reality, the remuneration received by an executive compensation consultant from these other services will undoubtedly be viewed as potentially compromising the independence of the consultant's advice.

Most corporate governance advocates believe that, a advisor to the board compensation committee should be free of any relationship with the company or its management that may impair, or appear to impair, its ability to provide independent advice and assistance to the committee. Consequently, the receipt of remuneration from the company, directly or indirectly, other than for the executive compensation consulting services rendered to, or at the direction of the board compensation committee, should be avoided.

Given the array of services provided by many of the firms that offer executive compensation consulting, as well as the size and complexity of these firms, identifying and quantifying the additional services they may be providing will not be easy. Many firms that offer executive compensation consulting also offer other services, some of which can generate greater fees than those generated by working with the board compensation committee. These services may include:

- advising individual executives
- SFAS 123(R)-related valuation services
- insurance brokerage services
- pension or actuarial consulting
- nonqualified deferred compensation consulting
- human resource outsourcing services
- executive search services
- tax, financial planning, and/or investment advisory services

The SEC's New Disclosure Proposals (continued)

- broad-based wage and salary administration services
- market pay survey databases

Any of these activities may raise questions about the independence or objectivity of the compensation consultant in advising board compensation committees on executive compensation matters. Moreover, the existence of a potentially problematic relationship may not be obvious – an engagement between affiliates of both the company and the compensation consultant is easy to overlook, but, with hindsight, may be difficult to explain – particularly under the glare of shareholder scrutiny. Consequently, companies should begin identifying and evaluating any existing relationships that may be subject to disclosure and justification.

By taking action now, board compensation committees can identify any potential issues in advance of the 2010 proxy season and develop appropriate disclosure approaches and, if warranted, remedial actions.

Need Assistance?

If you would like to speak with a Compensia consultant about your board compensation committee's responsibilities and any other executive or equity compensation-related matters, please feel free to contact us. ■

About Compensia

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