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Executive Compensation Consultants: The Next Battlefield for Say on Pay

by Anne Moore Odell

Investors ask the SEC to mandate disclosure of a company's use of executive compensation consultants and if the consultants are used in other areas of the business as well.

SocialFunds.com -- A coalition of 21 institutional investors lead by [Connecticut Treasurer](#) Denise Nappier, recently sent a letter to the Security and Exchanges Commission ([SEC](#)) asking the SEC to require companies to disclose to shareholders in annual proxy statements whether consultants working for compensation committees are also providing consulting or employee benefits services to the management of the same companies.

The letter also calls for companies to disclose any ownership interest the consultant may have in the parent consulting company. Investors are concerned that advice given to a compensation committee may be compromised in the form of higher pay if the consultant also provides more lucrative services for management.

"Investors concerned about sustainability issues, such as social equity and the environment, appreciate that compensation consultant independence can just as certainly impact the bottom line," said Denise L. Nappier, Treasurer of the State of Connecticut and principal fiduciary of the \$26 billion Connecticut Retirement Plans and Trust Funds (CRPTF).

"We believe that good board practices -- including the decisions around executive pay -- support the long-term viability of a company by creating appropriate incentives for executives. Executives' pay should be tied to performance, and that performance undoubtedly includes the successful achievement of those goals that support and advance business practices related to sustainability," she added.

The letter addressed to SEC Chairman Christopher Cox reads in part: "We believe a potential conflict of interest exists at companies in which consultants are hired to do work for both a company's management and its compensation committee. When a consultant performs such services as benefits management on the one hand and advises the board's compensation committee on executive pay matters on the other hand, we believe that the consultant's integrity may be jeopardized."

The signatories to the letter represent \$1.4 trillion in assets under management and include state and local treasurers and comptrollers from California, Connecticut, Florida, Illinois, Maryland, New York City, New York State, and North Carolina. Other institutional investors signers to the letter include AFL-CIO Reserve Fund, Amalgamated Bank LongView Funds, Hermes Equity Ownership Services Limited, International Brotherhood of Teamsters, Master Trust, Universities Superannuation Scheme Ltd; and Walden Asset Management.

In December 2007, [James F. Reda](#) testified before the House Oversight Committee on the actual or perceived conflicts of interest of full service consulting firms that offer management services beyond executive compensation consulting. Even with the firewalls in place to separate executive compensation consulting from other parts of their business, he points to possible conflicts of interest or the appearance of a conflict.

Reda is the managing director of James F. Reda & Associates, which solely provides compensation consulting and no other management services. Reda explained that

up to 90% of Fortune 1000 use executive compensation consultants.

Currently, the SEC only requires companies to disclose the name of the consultants and not the fees paid to them. The House Oversight Committee has collected this data in the past, but it is not publicly available to investors and others. Reda suggests companies disclose all fees paid to compensation consultants for compensation consulting and all the fees paid to the consultants firm for other services, and to also disclose the type of work performed by the consultant. Reda compares the disclosure of the independence of compensation consultants to the disclosure of the independence of auditors to senior management.

"You want to be sure that advice on executive pay is coming from an independent voice, that the consultant has no other considerations, as shareholders can't be in compensation committee meetings," Reda explained.

The issue of compensation consultants disclosure is part of the larger issue concerning executive compensation packages. In 2001, Napier filed the first shareholder resolution from the Connecticut Treasurer's Office calling for a link between executive pay and performance. Since that time, Nappier's office has worked diligently to address executive compensation.

"Today, there is no disputing the fact that CEO compensation has become a growing concern of shareholders, and one that has caught the attention of the business community, regulators, Congress and the media -- fueled in part by the exorbitant pay packages granted to CEOs while company performance stalled miserably, shareholder value dropped steeply and workers lost their jobs, their life savings or both," Nappier told Socialfunds.com. "No doubt, the failure of a company's board of directors to take charge and adopt responsible executive compensation policies has forced more shareholders to take notice and help set the stage for tangible progress on this issue."

Nappier pointed to recent developments regarding the new SEC ruling concerning the transparency and disclosure of CEO compensation, and rise in shareholder votes pushing for greater board accountability in setting CEO compensation policies and practices as examples of this growing concern. Compensation consultant independence is an issue that grew out of Nappier's work on the quality of disclosures on executive pay in the annual proxy statements.

"My administration's initiative with respect to executive compensation began in 2006 when my office led an investor coalition in calling on 25 of the largest U.S. companies to adopt policies on compensation consultant independence, and to report such policies and practices in the 2007 proxies," said Nappier.

Nappier continued, "This year, we are once again addressing related executive compensation issues that have been put forth during the last two proxy seasons, including investor advisory votes on pay packages known as 'Say on Pay.' We are also embarking on a new compensation issue with two companies (Abercrombie & Fitch and SUPERVALU) related to the gap in pay between the CEO and the second in command. Big pay gaps may signal a lack of delegation of power and poor board practices related to succession planning."

Changes in the SEC's disclosure regulations on executive compensation are in the wind Nappier believes. She points out that candidates from both parties have pledged to pass legislation to support shareholder advisory votes. Last month, Senator Hillary Rodham Clinton introduced the "Corporate Executive Compensation and Accountability Transparency Act" (S. 2866) which has several important pay-related proposals, including requiring the SEC to promulgate rules "clarifying and strengthening" the disclosure requirements concerning pay to compensation consultants.

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