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Investors Call for Disclosure of Executive Compensation Consultant Work; Cite Potential Conflict of Interest That Could Lead to Higher CEO Pay

Lack of Independence May Influence Advice Provided to Board

Due to concerns that perceived or actual conflicts of interest could contribute to rising levels of executive pay, a coalition of institutional investors representing $849.5 billion in assets is calling on the nation's top corporations to take steps to end the practice of board-hired compensation consultants also doing work for company management.

In a joint letter sent to the compensation committee chairs of the 25 largest U.S. companies (by market capitalization) in the S&P 500, the investors called on the companies to:

- Inform investors of the nature and extent of work being done for company management by consulting firms that also recommend executive pay packages to the board's compensation committee,
- Provide information on any existing board policies to prevent or prohibit the same consulting firm from providing services to both management and the board, and
- Express a willingness to adopt formal policies to prevent compensation consultants from working for both management and the board.

"We believe that it is in the best interest of shareholders and corporations for compensation consultants to provide independent, unbiased advice regarding executive compensation," stated the letter, adding "it is critical, therefore, that a compensation consultant be free of any conflict of interest, perceived or actual."

Connecticut Treasurer Denise L. Nappier, principal fiduciary of the $23 billion Connecticut Retirement Plans and Trust Funds, is leading the effort. "When a company's compensation consultant has a lucrative relationship with the company, and then recommends pay packages for executives, the dual relationship can not only hurt shareholder value, but the resulting exorbitant pay increases can set an inflated benchmark for truly independent consultants seeking to ensure that the companies they represent remain competitive in attracting and retaining top-flight executives."

Institutional investors signing on include the California State Teachers Retirement System, North Carolina Retirement Systems, New York State Common Retirement Fund, New York City Pension Plans, AFL-CIO Reserve Fund, SEIU Pension Fund, State of Illinois Board of Investment, F&C Asset Management, Walden Asset Management, The International Brotherhood of Teamsters, Universities Superannuation Scheme Ltd., and Central Laborer's Pension Fund.

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The investors drew parallels to past concerns regarding audit firms receiving compensation for providing consulting work for the same corporation, a practice that came under scrutiny in 2000 and was later directly addressed as part of the corporate governance Sarbanes-Oxley reforms in the wake of Enron and other corporate scandals.

"The concerns that institutional investors have regarding compensation consultant independence are analogous to those raised in recent years regarding auditor independence," the letter said. "The value of auditor independence is clear, particularly when measured against the accounting scandals at companies where an accountant's role as auditor conflicted with its often far more lucrative role as consultant."

The investors described a prohibition on consultant firms providing services for both a company and the board's compensation committee as a good governance practice that would contribute to alleviating continuing investor concerns about exorbitant executive pay, especially in circumstances where company performance lags.

"Multiple business relationships within a company may compromise the independence of a consultant's recommendation to the compensation committee and may jeopardize shareholder confidence," the letter stated.

The SEC recently issued revised rules calling for the disclosure of compensation consultants. While the rules require for the first time that the company share with investors the identification, role and hiring contact of the consultant, they did not require disclosure of whether the consultant performed other services for management of the same company – a significant omission in the view of the coalition of investors.

The investors noted that The Conference Board asserted in a report issued in December, 2005 that "compensation consultants can indeed be conflicted when they also provide services for management of the same company." The Conference Board is a non-profit organization that brings together executives and corporate board members to share ideas on improving performance and strengthening corporate governance.

The compensation committee chairs of the following companies were sent the letter today: Hewlett Packard Co., General Electric Co., Merck & Co., AT&T, Wachovia Corp., CitiGroup, Johnson & Johnson, Pfizer Inc., Bank of America, ConocoPhilips, JPMorgan Chase, ExxonMobil, Wal Mart Stores, Cisco Systems Inc., Microsoft Corp., Procter and Gamble Co., Morgan Stanley, Goldman Sachs Group Inc., Motorola Inc., Home Depot, Texas Instruments Inc., Occidental Petroleum, Dow Chemical, Lockheed Martin Corp. and Verizon Communications.

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