



DENISE L. NAPIER
TREASURER

State of Connecticut
Office of the Treasurer

HOWARD G. RIFKIN
DEPUTY TREASURER

May 12, 2008

The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Cox:

As a coalition of 21 institutional investors representing \$1.4 trillion in assets, we write today to bring to your attention our concern about the need for greater disclosure in the area of compensation consultant independence.

Investors need sound information in order to make prudent decisions, including information that will allow investors to assess the independence of the compensation consultant engaged by the board compensation committee. 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. We refer you to the enclosed detailed comments.

Therefore, we are asking the Commission to consider requiring companies to disclose in the proxy statement the fees associated with all engagements for a single company and any ownership interest a consultant working for the compensation committee may have in the parent consulting firm.

We are also requesting a meeting with you and other Commissioners to discuss this issue. It is our belief that you are as committed to the idea of compensation consultant independence as we are, and we are eager to meet with you to explore ways we, as shareholders, and you, as a regulation commission, can bring about this desired goal.

We are available to meet with you at your convenience to discuss these issues further. Please contact Meredith Miller, Assistant Treasurer for Policy, Office of the Connecticut State Treasurer (860) 702-3294.

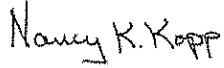
Thank you.

Sincerely,

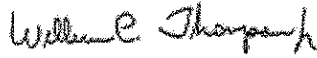
Denise L. Nappier
Treasurer
State of Connecticut

Richard H. Moore
Treasurer
State of North Carolina

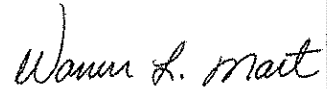
Thomas P. DiNapoli
Comptroller
State of New York



Nancy Kopp
Chairman
Board of Trustees
State Retirement and
Pension System of Maryland



William C. Thompson, Jr.
Comptroller
City of New York



Warren Mart
Co-Chairman, Board of
Trustees
I.A.M. National Pension Fund
General Secretary-Treasurer
IAMAW



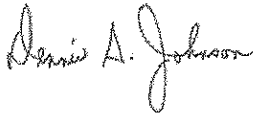
Jack Ehnes
CEO
CalSTRS



Colin Melvin
CEO
Hermes Equity Ownership
Services Limited



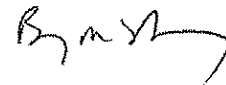
C. Thomas Keegel
General Secretary-Treasurer
International Brotherhood of
Teamsters



Dennis A. Johnson
Senior Portfolio Manager
CalSTRS



William Atwood
Executive Director
Board of Investment
State of Illinois



Barry McAnarney
Executive Director
Central Laborers' Pension,
Welfare & Annuity Funds



Dan Slack
Executive Director
Illinois State Universities
Retirement System



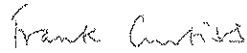
Stephen Abrecht
Director
SEIU Master Trust



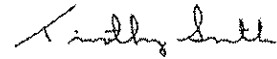
Mike McCauley
Senior Corporate Governance
Florida State Board of
Administration



Dan Pedrotty
Director, Office of Investment
AFL-CIO Reserve Fund



Frank Curtiss
Head of Corporate Governance
Railpen Investments



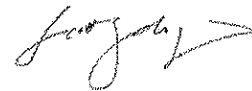
Tim Smith
Senior Vice President
Walden Asset Management



Jason Fletcher
Head of Americas Equities
Universities Superannuation
Scheme Ltd



Elizabeth McGeeran
Senior Vice President
Governance and Sustainable
Investment
F&C Management Ltd



Scott Zdrazil
Vice President
Director of Corporate
Governance
Amalgamated Bank

Attachment

Detailed Comments on Compensation Consultant Independence

The following comments are submitted in support of the May 12, 2008, letter from a coalition of institutional investors and their representative bodies with assets under management exceeding \$1.4 trillion.

Background

The work of board compensation committees is scrutinized closely by investors, proxy advisors and the media, as directors attempt to find a balance between the pressure to avoid excessive pay embarrassments and the demand that valued executive talent be attracted and retained. The complexity of compensation plans and programs, including the interaction among plans and debates over appropriate metrics and hurdles, adds to the challenges facing compensation committees.

Compensation consultants now play a key role in the pay-setting process by anchoring the committees' deliberations through data on peer group companies and by recommending pay arrangements. Use of an outside consultant has become more the norm than the exception. According to a recent study by The Corporate Library, 51% of companies in the Russell 3000 index that filed proxy statements in February through May of 2007 identified a specific compensation consultant that provided services to the compensation committee, with additional companies reporting that a consultant was used but not identifying it by name.¹ An even larger proportion of Fortune 250 companies—over 77%—disclosed retaining a compensation consultant in 2007 proxy filings, according to a December 2007 study by the House Committee on Oversight and Government Reform (“Oversight Committee Study”).²

Potential Conflicts of Interest

With companies' reliance on compensation consultants, investors are concerned that the advice provided by these consultants may be biased as a result of potential conflicts of interest. Most firms that provide compensation consulting services also provide other kinds of services, such as benefits administration, human resources consulting and actuarial services. The Oversight Committee Study documented that it is common for a firm to be engaged to provide other services at companies where the firm advises on executive compensation: such arrangements were found at 113 of the Fortune 250 companies included in the study. A dramatic difference was found in the revenues generated by these activities, which are much more lucrative than compensation consulting. On average, \$2.3 million was received for other services at these companies while \$220,000 was received for compensation consulting while, a ratio of approximately 11 to 1. At 27 companies, the ratio was more than 20 to 1.³

¹ Alexandra Higgins, “The Effect of Compensation Consultants: A Study of Market Share and Compensation Policy Advice,” at 2 (The Corporate Library Oct. 2007).

² United States House of Representatives, Committee on Oversight and Government Reform, “Executive Pay: Conflicts of Interest among Compensation Consultants,” at 4 (Dec. 2007).

³ Id.

Even more troubling, the Oversight Committee Study found that companies using consultants with the most acute potential conflicts of interest (as measured by the fee ratios) reported median compensation of \$12.5 million for 2006, 67% higher than the median compensation of \$7.5 million paid to companies whose consultants did not have conflicts of interest. A similar, though less striking, correlation was found when comparing compensation at all companies using conflicted consultants (regardless of the disparity in the fee ratio) against compensation at companies using non-conflicted consultants.⁴

Some consulting firms argue that they manage such conflicts by tying the pay of compensation consultants only to the fortunes of the compensation consulting unit and not to other units in the firm that might seek to provide services to the same companies. We believe that these kinds of measures are inadequate because they ignore the fact that compensation consultants may own equity interests in the firm and thus benefit from non-compensation-consulting engagements landed by the firm. Testimony by James Reda, founder and managing director of James F. Reda & Associates, before the House Committee on Oversight and Government Reform at a December 2007 hearing on the link between compensation consultant independence and executive pay underscores the internal conflict arising for compensation consultants with an equity stake in their consulting firms when the firms do other business for the company:

[T]hese consultants are part of a bigger organization. They hold stock in the actual organization that they're a member of. So, depending on how well they do selling...the more they sell, the more they earn their retirement and increase their wealth.

[T]hese Chinese walls and firewalls do not work because of the economic interest of the [compensation consultants] who work for [the consulting] firm—they are essentially tied at the hip economically, and it's impossible to break that tie.⁵

In its 2006 rulemaking revamping disclosures around executive compensation, the Commission recognized the important role played by consultants, stating that the “involvement of compensation consultants and their interaction with the compensation committee is material information that should be required.” To that end, the rules adopted in 2006 require companies to disclose:

any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether such consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any

⁴ *Id.* at 6.

⁵ United States House of Representatives, Committee on Oversight and Government Reform, Hearing on Executive Pay: The Role of Compensation Consultants (December 5, 2007), at 123-124.

other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.⁶

Problems with Current Disclosure Rules

The current rules do not, however, compel companies to disclose the information necessary to assess whether compensation consultants are independent. Specifically, companies do not have to reveal (a) fees paid for services provided to the compensation committee, (b) whether any firm providing compensation consulting services was engaged to perform other services for the company, management or any named executive officer; or (c) if it was, how much the firm was paid for providing such other services. The current rules also do not require disclosure of any ownership interest an individual compensation consultant providing services to the board has in the firm as a whole.

During the 2006 rulemaking process, a significant number of commentators, including many large U.S. and foreign investors, urged the Commission to expand the proposed disclosure on compensation consultants to include disclosure of other engagements and related fees.⁷ These commentators argued that the independence of the compensation consultant matters a great deal to investors in evaluating the work of the compensation committee, especially in light of the fact that companies often promote the consultant's independence in their proxy statements. The Commission's final rule did not incorporate these suggestions.

The Case for Fuller Disclosure

Since the 2006 rulemaking, the case for disclosure of other engagements and fees has become even more compelling. The Oversight Committee Study has only increased the concern investors have about the effect of conflicted compensation advice. In addition to the findings discussed above, the Oversight Committee Study found that 30 companies described their consultants as "independent" in their proxy statements even though those consulting firms performed other work for the companies. The fact that the Oversight Committee Study, which to our knowledge was the first to examine compensation consultant conflicts of interest, was entirely dependent upon the power of the committee's chairman to obtain non-public data regarding these matters highlights the gaps in the current disclosure requirements.

⁶ Item 407(e) of Regulation S-K, 17 C.F.R. section 229.407(e).

⁷ See, e.g., comment letters from a group of institutional investors, including CalPERS, CalSTRS, Florida State Board of Administration, New York State Common Retirement System, New York City Pension Funds, PGGM, ABP, Hermes, Universities Superannuation Scheme, UniSuper, London Pensions Fund Authority, F&C Asset Management, Co-operative Insurance Society, Illinois State Board of Investment, Ontario Teachers Pension Plan, Public Sector and Commonwealth Super, and Railpen Investments (Apr. 10, 2006); CFA Institute for Financial Market Integrity (Apr. 13, 2006); Denise Nappier, Connecticut State Treasurer (Apr. 10, 2006); Michelle Leder (Apr. 13, 2006).

In December 2007, the CFA Institute for Financial Market Integrity—part of the CFA Institute, a global non-profit professional association representing financial analysts, portfolio managers, and other investment professionals—asked the Commission to improve its executive compensation disclosure rules by, among other things, requiring disclosure of amounts paid to a board’s compensation consulting firm for other work for the company. The letter argued that such disclosure “will allow shareowners to determine whether the board’s consultants are sufficiently independent from senior management with regard to executive compensation advice.”⁸

A private market-based solution to this information gap is unlikely, in our view. A regulatory solution would level the playing field and enable all investors to have meaningful information about the independence of the consultant, information that we believe is as material to the quality of the advice committees rely on as the nature and scope of the assignment. We therefore urge the Commission to revisit the question of requiring proxy statement disclosure of fees associated with all engagements for a single company and any ownership interest a consultant working for the compensation committee may have in the parent consulting firm.

⁸ See Letter from Kurt Schacht, CFA and James C. Allen, CFA to John W. White, Directors, Division of Corporation Finance, Securities and Exchange Commission, at 4 (Dec. 20, 2007) (available at http://www.cfainstitute.org/centre/topics/comment/2007/pdf/exec_comp_followup.pdf).