

Mercer Talks to Us about the New Rules on Compensation Consultant Conflicts Disclosure

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The new SEC rules regarding compensation committee independence and compensation advisers' relationships require disclosure of whether the work of certain compensation consultants have raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. In assessing whether a conflict exists, committees are to consider six factors listed in the SEC rules. If disclosure is necessary, it must be included in proxy statements for annual meetings beginning January 1, 2013. The rules amend existing Item 407 of Regulation S-K, and unlike other elements of the new rules, no listing standards are needed to make them effective.

We turned to Gregg Passin, Partner at Mercer, to give us the compensation consultants' perspective of these rules.

Davis Polk: How are compensation consultants preparing to help companies and compensation committees assess whether conflicts exist so as to require disclosure?

Mercer: At Mercer, we have established a pretty straight forward and easy process for providing our existing and prospective clients the information they need to address the six factors in the SEC rules to the extent that the information is reasonably available to us. This is an extension of the process we implemented in 2010 to provide clients with the information they needed to meet their consultant fee disclosure obligations.

Davis Polk: Is there much overlap between these rules and the existing disclosure rules pertaining to consultants' roles in executive and director compensation?

Mercer: Under the existing rules, companies must identify any consultant who played a role in determining or recommending executive and director compensation, state whether those consultants were engaged directly by the compensation committee and describe the nature and scope of the consultants' assignment. In certain circumstances, companies must also disclose the aggregate fees for executive and director compensation consulting and any other services provided by the consultant.

The new rules ? which apply to any consultants the company was required to identify under the existing rules ? go one step further by requiring companies to undertake a conflict of interest analysis using the six factors. If the company determines that there is a conflict of interest, further disclosure is triggered with respect to the nature of the conflict and how it was resolved.

Davis Polk: Can you speak about any policies and procedures that consultants have designed to avoid conflicts?

Mercer: Mercer has had Global Business Standards (GBS) in place for our executive rewards consulting for many years. We adopted the GBS to manage potential conflicts of interest and preserve the integrity of our advice. The GBS address how we manage our consulting relationships, ensure the quality of our consulting services and structure our business to manage potential conflicts of interest. We believe that core to providing objective advice is having a clearly defined and documented understanding of our relationship with the client, including how information is shared and recommendations reported. We apply these standards whether we are retained by a committee of the board or by the management team.

Davis Polk: What has been the biggest challenge for companies and consultants in terms of compliance?

Mercer: We are just beginning to work with clients on assessing the six factors. One area that is presenting challenges is the lack of guidance on defining key terms. For example, we do not know whether references to the "consultant" are to the lead consultant on a team or every team member or what actually falls into the definition of business or personal relationships with executive officers or directors. We anticipate that our clients' counsel will be providing guidance that will inform our process as we all get more experience working with the factors.

Davis Polk: Do you have any recommendations with respect to how companies and compensation consultants should think about this new requirement?

In their totality, the six factors make good governance sense without creating an undue burden on any of the parties. We believe that reviewing any advisory relationship against the factors is a worthwhile process and provides an opportunity for dialogue that enables clients to evaluate actual or perceived conflicts and assess the objectivity of the advice they receive.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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