TOWERS WATSON

71 South Wacker Drive
Suite 2600
Chicago, IL 60606-4637

T +1 312 201 6300

towerswatson.com

October 5, 2010

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Dear Ms. Murphy:

**Re: Comments on Section 952, Compensation Committee Independence in Title IX, Subtitle E of the Dodd-Frank Wall Street Reform and Consumer Protection Act**

Towers Watson is pleased to submit comments to the Securities and Exchange Commission providing our perspective on how the Commission should interpret the compensation consultant independence provisions of Section 952 in Title IX, Subtitle E, of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. Our Talent and Rewards segment includes the world's largest executive compensation advisory practice, encompassing approximately 300 consultants in 35 cities worldwide. We hope the Commission will consider the following comments and recommendations as it moves toward proposing regulations regarding issuers' use of executive compensation consultants.

## I. Our Point of View

Towers Watson and our predecessor firms have played an active role in the public debate about the role of compensation consultants and, in particular, potential conflicts of interest that may affect the objectivity of a consultant's advice to a client. We concur with many of the central themes concerning compensation consultants that are stated or implied by the Dodd-Frank Act. In particular, we are pleased that Dodd-Frank reaches three key conclusions with which we wholeheartedly concur:

1. **When engaging executive compensation advisers, compensation committees should take into account a range of factors that may have an influence on the adviser's objectivity and independence.**

   Congress properly recognizes that compensation committees should take a broad focus when considering the factors involved in selecting consultants to advise them on executive compensation matters. This is a complex area and the Commission's rules should enable directors to feel confident that they are receiving objective and insightful advice from a reliable and competent source. Having the flexibility to choose a competent expert is also an important fiduciary consideration for directors under state corporation law.

   In enacting Dodd-Frank, Congress makes it clear that compensation committees should consider at least five identified factors when selecting a compensation consultant, legal counsel or other adviser. Congress correctly recognized that requiring compensation committees to focus on a broader range of factors than just fees for other services will provide a more complete picture of whether an adviser has relationships that could give rise to a conflict of interest that might impair the objectivity of the advice the committee receives.

Under the Commission's current proxy disclosure rules, whether or not an adviser's firm provides "other services" in addition to executive compensation advisory services is perceived as the sole factor to be considered in assessing a consultant's independence. However, as Dodd-Frank explicitly recognizes, committees should give equal attention to an adviser's other business and personal relationships with the company. While such relationships shouldn't automatically disqualify an adviser (nor should the adviser's provision of other services to the same company), we agree with Congress that they should be considered.

In this regard, we believe it would be useful for SEC regulations to provide principles-based examples of such potential considerations (along the lines of the Compensation Discussion and Analysis (CD&A) requirements that provide illustrative examples of possible considerations). However, we also believe it is critical for committees to have the ultimate say in determining the importance and relevance of any potential or actual conflict, taking into account an appropriate range of considerations (e.g., the likelihood that a potential conflict could influence the adviser's recommendations and any protocols the adviser's firm follows to mitigate potential conflicts).

2. **By calling for the Commission's regulations to be "competitively neutral" among categories of consultants, legal counsel and other advisers, Congress wants the Commission to ensure that companies have the flexibility to select the types of adviser that best meet their particular needs.**

   Congress recognized that the existing proxy disclosure rules, which focus on a single factor (i.e., fees for other services provided by multi-service consulting firms) without consideration of other potentially mitigating factors, have the potential to limit companies' ability to use the services of highly qualified executive compensation advisers. As a result, the statute mandates that the Commission's rules must ensure that the factors to be considered are competitively neutral among categories of advisers and preserve the ability of compensation committees to retain the services of a wide range of advisory firms. Inclusion of this provision suggests that the Commission's rulemaking should take a broad view of the compensation consulting landscape and fashion an approach that permits compensation committees to select the most appropriate advisers for their specific needs. (See our recommendation in II.A.2 below.)

3. **Given that potential conflicts are inherent whenever advisers are paid for services (and, thus, no category of adviser is inherently conflict-free), advisers can mitigate or eliminate these potential conflicts through effective policies and procedures.**

   For example, Towers Watson consultants are subject to a rigorous code of conduct and other consulting protocols that are specific to executive compensation engagements. Our policies and protocols help to ensure that the advice our consultants provide is objective. We believe every firm that advises compensation committees should have in place similarly rigorous processes. In our view, advisers who cannot demonstrate that they maintain effective consulting protocols, consistently enforce those protocols and have an established track record showing that they have effectively mitigated potential conflicts should not be retained by compensation committees.

## II. Specific Recommendations

Following are specific suggestions about factors compensation committees should consider in hiring advisers and how any potential conflicts of interest should be disclosed.

### A. Factors to Be Considered By Compensation Committees When Hiring Advisers

1. Section 10C(b) does not explicitly provide that issuers must disclose in their proxy statements the factors the compensation committee considered in hiring its advisers. Rather, the exchange listing requirements would merely require that the factors identified by the Commission be considered by the compensation committee in evaluating an adviser's independence. This contrasts with section 10C(c)(2), which requires proxy disclosure of whether "the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed." We would hope that the Commission will permit compensation committees to weigh the relevant factors, as appropriate for their particular circumstances, without increasing the burden on issuers to prepare an additional disclosure. We recognize, however, that some issuers may determine it is in their interest to disclose the specific factors considered by the compensation committee, particularly when they determine that these considerations might be relevant to shareholders.

   **Recommendation:** The Commission should develop exchange listing requirements that require compensation committees simply to document in their minutes how they considered the factors listed in the statute and regulations.

2. Section 10C(b)(2) acknowledges that an executive compensation adviser's independence could be compromised for various reasons that extend beyond the provision of additional services to the company. Based on this broader definition, we expect that compensation committees are likely to identify one or more potential independence issues for most qualified advisers and will need to decide how such issues should affect their selection decisions.

   **Recommendation:** The Commission should make it explicit that each factor a committee might consider is to be weighed based on the discretion of the compensation committee and that no one factor must be considered more or less important than any other. The Commission should also clarify that the existence of any potential conflict should not automatically disqualify any adviser from being hired by the compensation committee. We also think it would be helpful for the Commission to provide examples that illustrate how compensation committees might determine it was appropriate to hire an adviser even where a potential conflict was identified.

   An appropriate example would involve a multi-service firm that advises an issuer's compensation committee and also performs over $120,000 in consulting services to management. The example could note that, despite the existence of these "other services," the compensation committee determined the adviser's firm had in place rigorous internal protocols and ethical standards that helped to ensure the advice being provided to the committee was objective, unbiased and free of any conflicts of interest.

3. Section 10C(b)(2)(D) provides that compensation committees must consider "any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee" when determining independence. We believe that Congress included this provision to recognize that business or personal relationships can exist in many forms, each of which can give rise to a potential conflict of interest that might affect the objectivity of the adviser's advice.

**Recommendation:** The Commission's rulemaking should emphasize the breadth of potential business and personal relationships and should require that each of these be considered by compensation committees in evaluating the independence of their advisers. We also suggest that the Commission should consider more fully defining the term "business or personal relationships," possibly by providing examples to guide compensation committees. One such example might address the not-uncommon situation where an individual serves as chair of the compensation committees of several companies and retains the same adviser to assist all of these committees, such that the adviser's relationship with this director represents a significant portion of the adviser's overall book of business. There are numerous other possible scenarios the Commission could address to help committees think through the implications of various "business or personal relationships."

4. While the factors listed in Section 10C(b)(2) will assist compensation committees in determining if their advisers may have potential conflicts of interest, we believe there are equally important factors compensation committees should consider in making their hiring decisions. These include the depth of knowledge and experience of the adviser and his or her firm, the adviser's ability to deliver high-quality and timely advice, the firm's ability to provide data and information about peer compensation pay practices, the technical and regulatory expertise of the adviser and his or her firm and the adviser's ability to interact effectively with the committee. These factors should be key to the compensation committee's decision-making process and may be relevant to memorialize as a matter of state law.

   **Recommendation:** The Commission's rulemaking should provide that compensation committees articulate key factors they consider in selecting their advisers in their minutes.

**B. Disclosure Rules for Conflicts of Interest**

1. As Section 10C(2)(B) acknowledges, potential conflicts of interest are pervasive in business relationships and most companies do a good job of managing these conflicts in a manner that does not compromise the advice or services being provided. This is reflected in the statute itself, which notes that an adviser's work can raise a potential conflict of interest, while requiring only that issuers disclose the nature of the potential conflicts and how they are being addressed. While we agree with this perspective, we are concerned that the statute is written in a manner that will yield far less disclosure than Congress may have intended.

   Consider the recent example regarding the current proxy disclosure rules, which require companies to determine if their compensation programs could promote excessive risk taking. If so, issuers must then include a lengthy description of the protections in place to prevent negative impacts on the company. The result during the first year this requirement was in effect was that virtually all issuers concluded that their programs did not cause excessive risk taking and that no disclosure was required, although many decided to provide disclosures voluntarily. The current rules regarding disclosure of excessive risk taking are analogous to the language of Section 10C(2)(B), which provides that each issuer must disclose "if the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed."

   **Recommendation:** While we do not encourage the Commission to expand the required disclosures on a mandatory basis, we recommend that the Commission encourage issuers to disclose information that would enable shareholders to understand why the committee's adviser does not have a conflict of interest. For example, a compensation committee may hire an adviser whose firm provides other services to management and is required to inform the committee of the firm's total fees for services provided to the issuer. The issuer might then disclose that this adviser's objectivity is not compromised because the adviser's firm maintains effective firewalls between the adviser and the rest of the engagement team, no compensation is paid to the committee's adviser based on services provided to management, the firm has strict ethical standards in place that are regularly enforced and the firm requires another senior consultant to review all significant recommendations to the compensation committee. Such policies and protocols are a hallmark of Towers Watson's efforts to ensure the objectivity of the executive compensation advice we provide to our clients and have proven over time to be effective means to manage any potential conflicts of interest.

## III. Conclusion

Ultimately, each company will need to define the governance framework that best meets its needs and select the executive compensation advisers it's most comfortable with. The goal should be to ensure that both the board and management receive objective, high-quality advice to help the company make sound decisions about its executive compensation programs. As Dodd-Frank confirms, there are multiple routes to that destination. The Commission's guidance should reinforce the intent of Dodd-Frank to place the assessment of advisers' independence squarely in the hands of the compensation committee, enabling the committee to select advisers based on a broad, holistic review of the committee's specific needs, the adviser's unique qualifications and all potential conflicts that may affect the objectivity of the adviser's recommendations.

We appreciate the opportunity to offer these comments and hope that the Commission finds our observations and recommendations useful in developing regulations to help companies comply with this important new law.

Sincerely,

Douglas J. Friske

Douglas Friske
Managing Director, Global Practice Leader

Paula Todd

Paula Todd
Senior Consultant

Steve Seelig
Executive Compensation Counsel, Research and Innovation Center

DF/PT/SS:cec