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April 29, 2011

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 Proposed Regulations on Compensation Consultant Independence, File Number S7-13-11

Towers Watson is pleased to submit comments on the Securities and Exchange Commission's recent proposal to require listing exchanges to develop rules to guide compensation committees in evaluating the independence of their compensation consultants, legal counsel or other advisers, based on the five factors listed in Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Among other things, the proposal would require companies to disclose whether or not their compensation consultant might have an actual conflict of interest, the factors considered by the compensation committee in making this determination and, where conflicts of interest exist, the degree to which those conflicts have been mitigated.

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. 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.

Towers Watson's Views

We concur with many of the central themes concerning compensation consultants that are stated or implied by the Dodd-Frank Act, which were discussed to our letter to the Commission on October 5, 2010 as well as below. In particular:

- 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. Dodd-Frank identified at least five factors that compensation committees should consider. These go beyond a narrow focus on the extent of other services a consultant's firm provides, which is currently the sole issue addressed by the Commission's consulting fee disclosure requirement.

- Compensation committees must 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).

- 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.

Because current fee disclosure requirements predominantly focus on multi-service consulting firms, they are not competitively neutral.

- 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. Towers Watson maintains a rigorous code of conduct and other protocols to ensure the advice our consultants provide is objective.

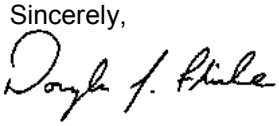
- All advisers to compensation committees who provide input concerning the level and form of executive pay — including consultants, lawyers, search firms, etc. — should be subject to the same standards regarding independence and disclosure. The specific role, rather than the label (e.g., consultant, lawyer, etc.), is what is relevant.

- In evaluating the independence of an adviser, compensation committees should look to the lead individual(s) who interact with the committee, rather than the firm that employs those individuals. For example, they should evaluate the individual's – rather than the firm's – ownership of stock, business or personal relationships, etc.

In the attached appendix, we offer detailed responses to a number of questions the Commission raised in your proposed rules.

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

Sincerely,



Douglas Friske
Managing Director, Global Practice Leader

Steve Seelig
Executive Compensation Counsel, Center for Research and Innovation

DF/PT/SS:cec

Appendix

In the following pages, we have addressed many of the questions the Commission posed in the proposing release that are of importance to Towers Watson and our clients. The questions are numbered for readers' convenience.

> **Question 1.** Is additional specificity in the proposed rule needed to provide clearer guidance to listed issuers? For example, should we define what constitutes an "independent legal counsel"? If so, how?
>
> **Question 2.** Should we clarify more explicitly in the implementing rule that this provision is not intended to preclude the compensation committee from conferring with in-house legal counsel or the company's outside counsel or from retaining non-independent counsel?

We address these questions together because they are closely related. In the preamble to the proposed regulations, the Commission states:

> [W]e do not construe the requirements related to independent legal counsel and other advisers as set forth in Section 10C(d)(1) of the Exchange Act as requiring a compensation committee to retain independent legal counsel or as precluding a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

We agree with the conclusion that a compensation committee is not required to retain "independent legal counsel," just as there is no statutory requirement that a compensation committee must retain an "independent" compensation consultant. We also agree that compensation committees are not precluded from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

However, whenever a compensation committee gets advice from counsel — independent, non-independent, in-house or outside counsel retained by the issuer or management — we believe Section 10C(b)(1) of the statute is unambiguous that "[t]he compensation committee of an issuer may only select a compensation consultant, legal counsel or other adviser to the compensation committee after taking into consideration the factors identified by the Commission under paragraph (2)."

The Commission should clarify in its final rules that no matter the circumstance where counsel is retained by or provides advice to the compensation committee, the listing exchange rules must require compensation committees to assess the factors listed in Section 10C(b)(2). In interpreting the phrase "obtained the advice" of counsel, the Commission should adopt a rule similar to that in the proposed Instruction 1 to Item 407(e)(3).

It is our experience that legal counsel often provides vital advice to compensation committees that can become the basis for decisions about the form, timing, structure and amount of compensation granted to executive officers. For example, when structuring a new employment agreement, legal counsel may advise the compensation committee on whether it is a prevalent practice to provide a change-in-control tax gross-up to executives, rather than simply opining on whether having a provision in an agreement would meet the requisite legal requirements. There are innumerable other examples of situations where legal counsel provides opinions on similar matters that can also include an assessment of whether the amount of compensation to be paid is appropriate under the circumstances.

In our view, failure to clarify this rule as we suggest would create a serious loophole in the regulations for those providing compensation advice who are lawyers or whose firms are organized as law firms. The marketplace already supports compensation advisers who are members of a state bar and provide advice to companies and compensation committees as counsel. These counsel often perform exactly the same services as a typical compensation consultant (e.g., analyzing peer company compensation, recommending compensation levels, designing compensation programs, etc.).

Question 3. Section 10C(b) specifies that the independence factors identified by the Commission must be competitively neutral, but does not state how we should determine whether a factor is competitively neutral. Are there any issues that should be considered to determine or assess whether a factor is competitively neutral?

We read the statutory language regarding competitive neutrality as acknowledging that the existing consulting fee disclosure regime, which disproportionately has affected multi-service firms, does not meet that standard. To ensure neutrality, the Commission should require disclosure of the dollar amount of fees paid to *all* compensation consultants. Doing so would help assure that the exchange listing and disclosure rules can be implemented in a manner that favors no particular category of consulting firm (i.e., multi-service firm, large boutique, single-person boutique, etc.). We believe committees should be permitted to take a holistic view in selecting independent compensation consultants, rather than be required to focus narrowly on any single factor.

Question 4. Are the five factors identified in Section 10C(b) of the Exchange Act competitively neutral among different types of compensation advisers? If not, what modifications or adjustments should be made in order to make these factors competitively neutral? Are there specific categories of compensation advisers that would be adversely affected by the compensation committee's use of these factors to assess independence?

Standing alone, these factors appear to be "competitively neutral." However, when considered in light of the recently adopted fee disclosure rules that disproportionately have affected multi-service firms, they are not. We believe the only way to remedy this issue would be to require fee disclosure for all compensation consultants, by dollar amount. We discuss this issue further in our answer to Question 13.

Question 5. Are there any factors affecting independence that we should add to the list of factors identified in proposed Rule 10C-1(b)(4)? If so, what are they and why should they be included?

Question 6. Would the existence of a business or personal relationship between a compensation adviser and an executive officer of the issuer be relevant in considering whether to engage the compensation adviser? If so, why? Should we add this to the required list of factors that must be considered?

In response to these questions, we believe the existence of a business or personal relationship between a compensation adviser (rather than the adviser's firm) and an executive officer of the issuer would be relevant to a determination of whether the adviser is "independent." We read the statute as focusing on any factors that could influence the objectivity of the adviser hired by the compensation committee, so the compensation committee should be made aware of relationships the adviser may have with the company. However, as we discuss in our answer to Question 7, this factor should focus only on the business or personal relationships the adviser has with an executive officer of the issuer, and not on those relationships the person (or firm) employing the adviser may have.

Question 7. Based on the language in Section 10C(b)(2), which distinguishes between the adviser and the person that employs the adviser, a personal or business relationship between the person employing the adviser and a member of the compensation committee would not be covered by the proposed rule (which, like Section 10C(b)(2)(D), only refers to relationships between the adviser and the compensation committee). Should the required list of factors also include a business or personal relationship between the person employing the compensation adviser and a member of the compensation committee? Along those lines, should it also cover a business or personal relationship between the person employing the adviser and an executive officer of the issuer?

In this regard, we believe it's important to keep in mind the statutory requirement that the factors to be used in evaluating independence must be "competitively neutral." If the rule were extended to require disclosure of business or personal relationships the person (or firm) employing the adviser might have with a member of the compensation committee, it would likely create a perception that multi-service firms have far more business or personal relationships simply because of their size. Moreover, such a rule

could create an extraordinary burden for large, multi-service firms with many thousands of employees globally. It would be virtually impossible for such a firm to provide information on the personal relationships or stock holdings of each employee to compensation committees seeking to hire an "independent" consultant. The net effect of adopting a firmwide rather than consultant-specific rule would be similar to that resulting from the Commission's previous decision to require fee disclosure only for multi-services firms, which has made some compensation committees hesitant to hire such firms as compensation committee advisers.

> **Question 8.** Should we provide materiality, numerical or other thresholds that would apply to whether or when the independence factors must be considered by a compensation committee? If so, what should they be? For example, should we require consideration of stock ownership only if the amount of stock owned constitutes a significant portion of an adviser's net worth, such as 10%?

We do not believe the Commission can set materiality, numerical or other thresholds without running the risk of creating rules that are not considered "competitively neutral." However, we believe the best way for the Commission to ensure that its rules are "competitively neutral" would be to permit compensation committees to consider other factors in determining whether its compensation adviser is "independent." This approach would properly leave the decision about which factors are important in the hands of the compensation committee.

> **Question 9.** Would law firms be affected by the requirement to consider independence factors in a way that would be materially different than how compensation consultants would be affected?

As we stated in our answer to Question 2, when legal counsel is retained by the compensation committee, the compensation committee should be required to consider the five factors listed in the statute to determine how they might influence the counsel's "independence."

> **Question 10.** Should we clarify what is covered by "provision of other services" in proposed Rule 10C-1(b)(4)(i)?

We believe companies will apply the same standard that they currently follow in complying with the fee disclosure rule in Item 407(e)(3)(iii), which uses the phrase "provided additional services to the registrant or its affiliates." No further clarification is required in our view.

> **Question 11.** We interpret "any stock of the issuer owned by the compensation consultant, independent legal counsel or other adviser" in proposed Rule 10C-1(b)(4)(v) to include shares owned by the individuals providing services to the compensation committee and their immediate family members. We do not believe this factor is intended to extend to the person that employs the adviser since Section 10C(b) is specific when factors extend to the employer and that language is not included for stock ownership. Is this an appropriate interpretation of this factor? If not, why and how should this phrase be interpreted? Should it also cover the person that employs the adviser?

We support the rule as currently proposed. Expanding this rule to the person (or firm) that employs the adviser would run afoul of the statutory requirement that the factors must be "competitively neutral."

> **Question 12.** Should we define or clarify the meaning of the phrase "business or personal relationship," as used in proposed Rule 10C-1(b)(4)(iv), and if so, how?

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. The Commission's rulemaking should emphasize the breadth of potential business and personal relationships and should require that each of these relationships be considered by compensation committees in evaluating the independence of their advisers.

To this end, we believe it would be helpful for the Commission to 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 work with 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. A second example (somewhat less common, but potentially of more concern from the standpoint of objectivity) involves cases where a CEO of one company serves on the compensation committee of another company and the same consultant advises both. Yet another example might involve the situation where a compensation committee member previously worked with an adviser. There are numerous scenarios the Commission could address to help committees think through the implications of various "business or personal relationships."

> **Question 13.** Would the proposed requirements have any unintended effects on the compensation committee or its process to select a compensation adviser? If so, please explain.

Our comments above touch on several potential unintended consequences of the proposed rules. Perhaps most important in this regard is our recommendation that the Commission should require fee disclosure for *all* categories of compensation consultants. Without this change, the proposed regulations would have the unintended consequence of maintaining a fee disclosure regime that focuses solely on multi-service firms and, thus, is not "competitively neutral."

> **Question 14.** Should we adopt rule amendments to Regulation S-K to require listed issuers to describe the compensation committee's process for selecting compensation advisers pursuant to the new listing standards? Would information about the compensation committee's selection process — how it works, what it requires, who is involved, when it takes place, whether it is followed — provide transparency to the compensation adviser selection process and provide investors with information that may be useful to them as they consider the effectiveness of the selection process? Or, would such a requirement result in too much detail about this process in the context of disclosure regarding executive compensation?

We believe Regulation S-K should be expanded to require disclosure of the factors considered and process by which the compensation committee determines that its compensation advisers are "independent." Beyond this, we believe it should be up to issuers themselves to provide additional information about the selection process if they believe this information is material to shareholders.

> **Question 15.** Should we extend any of the current exclusions under Item 407(e)(3) to the new Section 10C(c)(2) disclosures? Conversely, should we eliminate altogether the exclusions under Item 407(e)(3)?

We believe the existing exclusions under Item 407(e)(3) are appropriate as currently drafted and should be included in the final regulations for the new Section 10C(c)(2) disclosures. The original intent of these exceptions was to reduce the administrative burden on companies to disclose situations that fall short of being direct advice on executive compensation matters.

> **Question 16.** Is additional clarification necessary regarding the phrase "obtained the advice"? Does our proposed instruction provide adequate guidance to issuers on how to interpret that phrase?

The proposed Instruction 1 to Item 407(e)(3) would provide:

> For purposes of this paragraph, a compensation committee (or another board committee performing equivalent functions) or management has "obtained the advice" of a compensation consultant if such committee or management has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice.

We believe strongly that this proposed instruction is overly broad and should be amended to clarify those situations when disclosure would be required. There are two main issues we believe the Commission should consider.

First, the instruction is not clear as to those situations where management is required to disclose the use of a consultant. Item 407(e)(3)(iii)(B) provides that management is required to disclose its compensation consultant ***only*** in situations where "the compensation committee (or another board committee performing equivalent functions) has not retained or obtained the advice of a compensation consultant, but

management has retained or obtained the advice of a compensation consultant …," assuming the fees for such services exceed a certain threshold. The proposed instruction could be read to require disclosure regarding management's consultant even in situations where the compensation committee retains or obtains advice from its own compensation consultant. We do not believe that disclosure of the fact that management retains or obtains advice from a compensation consultant is required under these circumstances.

Second, we believe that requiring disclosure "regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice" could be read in a manner that is not intended. As mentioned above, it is quite common for management to hire its own compensation consultant in situations where the compensation committee retains a consultant. Under current rules, no fee disclosure is required in these circumstances, although the fact that management worked with its own compensation consultant would need to be disclosed. As proposed, the regulations would remove this disclosure obligation since it removed the requirement that "any role" of a compensation consultant would need to be disclosed. We agree with this proposed change.

However, the instruction would appear to require disclosure regarding management's consultant in cases where information that consultant provided to management was then shared with the compensation committee — a very common occurrence — even though no fees are being charged to the compensation committee and the management consultant never provides advice to the committee. We do not believe this is the Commission's intention.

As a result, we would propose that the instruction should read as follows:

> For purposes of this paragraph, a compensation committee (or another board committee performing equivalent functions) or management ***(where the compensation committee has not retained or obtained the advice of a compensation consultant)*** has "obtained the advice" of a compensation consultant if such committee or management has requested or received advice from a compensation consultant, ***but only where*** there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee, or management, or any payment of fees to the consultant for its advice.

Question 17. Do the five factors in proposed Rule 10C-1(b)(4)(i) through (v) help issuers determine whether there is a "conflict of interest"? Should we define the term "conflict of interest"? If so, how? Are there other factors that should be considered in determining whether there is a conflict of interest? If so, should these factors also be identified in the proposed instruction?

We agree that the five factors in proposed Rule 10C-1(b)(4)(i) through (v) will help issuers determine whether there is a conflict of interest and that issuers should be required to disclose how the compensation committee's consideration of these factors influenced this conclusion. While we agree that there may be other factors that would influence this determination, we would recommend that the Commission permit compensation committees to disclose those factors if relevant to their decision, but that the Commission should not define what those factors might be.

Question 18. Because a compensation committee may be reluctant or unable to definitively conclude whether a conflict of interest exists, should we also include the appearance of a conflict of interest in our interpretation of what constitutes a "conflict of interest" that must be disclosed under our proposed rules? Why or why not? Should we include potential conflicts of interest in our interpretation? Why or why not? We note that our 2009 amendments to Item 407(e) did not conclude that there was a conflict of interest posed by a consultant providing additional services to the issuer, only that there was a potential conflict of interest.

We agree that the proposed rule should require disclosure of when a compensation consultant would appear to have a conflict of interest and how the compensation committee determined this did not give rise to an actual conflict. Adopting this rule would acknowledge that potential conflicts are inherent whenever advisers are paid for services (and, thus, no category of adviser is inherently conflict-free), but that advisers can mitigate these potential conflicts through effective policies and procedures.

For example, a compensation committee may hire an adviser whose firm provides other services to management with the requirement that the adviser must inform the committee of the firm's total fees for services provided to the issuer. While this may appear to create a conflict of interest,[1] the issuer may conclude 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. Further, an issuer might also choose to disclose that it has reviewed the advice provided to it by the compensation consultant and has concluded that the firm's policies and procedures have, in fact, mitigated any potential conflicts of interest.

Moreover, we would hope that the final rule not only adopts the expanded disclosure in the proposed regulations, but that the Commission acknowledges in its final regulations that 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.

> **Question 19.** Should we should require fee disclosure for other types of potential conflicts of interest, such as revenue concentration, in light of Section 10C(c)(2)'s requirement that the factors considered by the compensation committee before engaging compensation advisers be "competitively neutral"? For example, to address revenue concentration, we could require disclosure of an adviser's fees received from the issuer (in percentage terms) if such fees comprise more than 10% of the adviser's annual revenues. Would this be appropriate?

For the reasons noted in our answer to Question 3, we believe fee disclosure for all compensation committee advisers should be required so these rules can meet the "competitively neutral" requirement. Without such disclosure, it will be difficult for the Commission to determine if this factor was properly considered by the compensation committee in making its determination of "independence." However, we do not believe the Commission should set dollar or percentage thresholds for fee disclosure because of the risk that any thresholds chosen would not be "competitively neutral."

> **Question 20.** Although a listed issuer's compensation committee is required to consider independence factors before selecting any compensation adviser, Section 10C(c)(2) requires conflict of interest disclosure only as to compensation consultants. Should we also extend this disclosure requirement to other types of advisers to the compensation committee, such as legal counsel? Why or why not?

As noted in our response to Question 2, other categories of advisers (e.g., lawyers) frequently advise compensation committees on the form and level of executive pay. In our view, treating these other advisers differently for disclosure purposes would fall short of the statutory requirement that the rules must be "competitively neutral." All advisers who provide input to compensation committees on the form and level of executive pay should be subject to the same standards.

[1] The Commission itself has previously acknowledged the importance of understanding where potential or apparent conflicts of interest exist as the basis for its current fee disclosure rules: "The extent of the fees and provision of additional services by a compensation consultant or its affiliate may create the ***risk of a conflict of interest*** [emphasis added] that may call into question the objectivity of the consultant's advice and recommendations on executive compensation." Preamble to Final Regulations, 74 Fed. Reg. 245 p. 68347.