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Disclosing Compensation Consultant Conflicts

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The Bankers' Statement – Winter 2013

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The SEC has added new Item 407(e)(3)(iv) to Regulation S-K requiring that a financial institution holding company include a disclosure in the annual proxy statement addressing whether the work performed by any compensation consultant raised a conflict of interest and, if so, the nature of the conflict and how it was addressed.

The requirements described in this article apply only to publicly-traded companies that are registered with the SEC. However, this disclosure is largely based on new requirements relating to the independence of the compensation committee and the compensation committee's access to independent advisers, which are discussed in the next article. As a result, as with other regulations, all financial institutions should expect the obligation to consider the independence of compensation consultants and other advisers to be subject to a "trickle-down" effect and "regulatory creep," as well as becoming "best practices." The issues and disclosures discussed herein are indicative of compensation, relationship and disclosure trends in business generally, and should be a guide for all institutions in dealing with compensation committees, compensation consultants and related issues.

When Disclosure is Required

Disclosure is required in a proxy statement filed with respect to any annual shareholders' meeting at which directors will be elected occurring on or after January 1, 2013.

For Whom Disclosure is Required

The compensation consultants for whom disclosure is required are those identified in the proxy statement as having any role in recommending or determining the amount of executive or director compensation, regardless of whether a particular compensation consultant was retained by the compensation committee or management.

Determining Whether a Conflict of Interest Exists

When determining whether the work performed by an individual compensation consultant raises a conflict of interest, financial institution holding companies should consider, at a minimum:

1. the other services provided to the holding company and its subsidiaries by the person employing the individual consultant;
2. the amount of fees received from the holding company and its subsidiaries by the person employing the individual consultant as a percentage of the employer's total revenue;
3. the policies and procedures of the person employing the individual consultant that are designed to prevent conflicts of interest;
4. any business or personal relationship of the individual consultant with a member of the compensation committee;
5. any holding company stock owned by the individual consultant; and
6. any business or personal relationship between the holding company's executive officers and the individual consultant or the person employing the individual consultant.

Recommendations

Because disclosure is required for the 2013 proxy season, each financial institution holding company should begin collecting the information necessary to determine whether the work performed by any individual compensation consultant raised a conflict of interest using the six factors identified above and any other factors that the holding company deems relevant. We recommend that each financial institution holding company:

- Require each compensation consultant to return a questionnaire providing the information contemplated by the six factors described above.
- Consider revising its director and officer questionnaire to solicit information regarding any business or personal relationships with any compensation consultant.
- Be prepared to describe in the proxy statement the process by which the holding company determined whether a conflict of interest existed.