The Office Of State Treasurer Denise L. Nappier

News

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Nappier Says Four Companies Agree to Connecticut Pension Fund Resolutions, Setting New Standard for Disclosure of Executive Compensation in 2008 Proxies

Companies Will Adopt Compensation Consultant Independence; Internal Pay Equity Policies in the CD&A

Connecticut Treasurer Denise L. Nappier announced today that four of the nation's largest companies, together representing nearly $109 billion dollars in total revenues, have settled shareholder resolutions that asked the companies to release detailed disclosures on executive pay-setting.

Nappier, principal fiduciary of the $26 billion Connecticut Retirement Plans and Trust Funds (CRPTF), is a leading advocate of corporate executive compensation that reflects company performance. Because of shareholder proposals filed on behalf of CRPTF this proxy season, retailer Abercrombie & Fitch and supermarket conglomerate Supervalu, Inc. have agreed to disclose information relating to gaps in pay among top executives. Shareholder agreement was also reached with printer R.R. Donnelley & Sons and the construction equipment manufacturer Caterpillar Inc.; both companies will disclose the relationship between compensation consultants engaged by their boards of directors and any additional work done for management. The CRPTF was the primary filer for all four resolutions, and was joined by the AFL-CIO Reserve Fund and the New York State Common Retirement Fund on the Caterpillar proposal.

Each company agreed to comply with a series of policies and disclosures relating to executive pay levels, prompting Nappier to withdraw shareholder proposals which would have otherwise been considered at the companies' annual meetings this spring.

One proposal filed at both Abercrombie and Supervalu asked each company to adopt policies on internal pay equity, which is the relationship between compensation received by the chief executive officer and that received by other named executive officers (NEOs).

"Large gaps in pay between the chief executive officer and other NEOs may signal that the CEO is earning an excessively large share of the compensation paid to top executives or that the pay is not tied to performance, and this is rightly of concern to shareholders," Nappier said. "It may also be a red flag for inadequate succession planning, as wide pay differentials sometimes reveal significant differences in contribution and ability and this, too, is troubling."

Equilar Inc., an executive compensation research firm, found that CEOs of American companies were paid nearly three times more than the average pay for all other NEOs. Credit rating issuer Moody's Investor Service has said that a multiplier between the CEO and any other NEO exceeding 3.0 times the total pay could negatively affect a company's debt rating and cost of capital, noting that a large gap may signal leadership failures at the board level. As part of the settlement, each company will exceed disclosure required by the Securities and Exchange Commission (SEC) by providing more details in the Compensation Discussion and Analysis (CD&A) section of the 2008 proxy statement on how internal pay equity is a factor in the pay-setting process.

Connecticut's announcement comes as the SEC evaluates responses to letters it sent to roughly 300 public companies requesting increased disclosure of executive compensation practices, including benchmarking and the use of internal and external performance targets. Based on initial responses to its letter, the SEC reaffirmed its view that when "the policy or decisions for a named executive officer are materially different, for example in the case of a principal executive officer, his or her compensation should be discussed separately."

CRPTF proposals at R.R. Donnelley and Caterpillar also asked the board compensation committee to adopt a policy that would preclude compensation consultants engaged by the board compensation committee from doing additional work for company management. R.R. Donnelley agreed to all provisions of the Connecticut Treasury's shareholder proposal, ensuring that the compensation consultant engaged by the committee is independent of management.

Caterpillar responded to the shareholder resolution on compensation consultant independence by agreeing to disclose in the 2008 CD&A the fees paid to Hewitt Associates LLC up to $500,000 worth of compensation consulting services vs. management contracts with Hewitt worth as much as $10 million. And in a precedent-setting disclosure, Caterpillar will also note that the Hewitt compensation consultant engaged by the compensation committee holds shares in Hewitt, a potential conflict of interest.

Nappier is now leading a coalition of institutional investors in drafting a letter to the SEC urging it to require all companies to disclose fees paid to the consulting firm engaged by the board compensation committee for executive compensation consulting and any other management services. A study released in December last year by the U.S. House Committee on Oversight and Government Reform showed that the most severe conflicts of interest between the board compensation consultant and management could result in executive pay roughly two thirds higher than at companies where the consulting is independent.

In an unprecedented move by investors, the letter also calls for disclosure of "any ownership interest a consultant working for the committee may have in the parent consulting firm." Although the so-called "full-service" firms—firms that have the capacity to provide both consulting and management-based services such as benefit plan administration and human resources consulting—often have some structures in place to separate the consulting business from other business units, the letter calls such measures "inadequate" because of the equity interest risk. Such a risk led James F. Reda, managing director of James F. Reda & Associates, to testify before the House Oversight Committee in December that compensation consultants who have ownership interests in the consulting firm are unable to remain neutral because their retirement and overall wealth are tied to the firm's ability to attract business.

Contact: Christine Palm
(860)702-3013
Christine.Palm@ct.gov

"Caterpillar has made great strides in its CD&A reporting through their willingness to disclose not only the fees paid for executive compensation consulting and management services, but also the fact that the compensation consultant holds an equity stake in the consulting firm," Nappier said. "Shareholders will finally have the information they need to make an informed decision on whether the company's compensation policies and practices adhere to high standards of professional ethics and best practices. The SEC should take note of Caterpillar's example and require these disclosures for all public companies."

This was not the first time Nappier has tackled the issue of compensation consultant independence. In October of 2006, she led a coalition of institutional investors representing $849.5 billion in assets under management to call on 25 of the nation's largest corporations to exceed SEC compensation reporting requirements in their 2007 annual reports by disclosing the nature of compensation consultant engagements, including whether or not the consultant was independent. Nappier previously wrote to the SEC asking it to require companies to provide adequate information for investors to use when evaluating the independence of the consultant.

"The oversized paychecks to executives complicit in the recent sub-prime debacle is just another example of the continuing saga of how some company board of directors abdicate their responsibility to ensure proper scrutiny and disclosure of executive pay packages," Nappier continued. "It underlines the fact that executive compensation inconsistent with company performance severely threatens the credibility of company leadership, and, over time, erodes that company's value to shareholders. These four companies have responded to the need for greater transparency on how executives are being paid—a critical step in allowing shareholders to evaluate how corporations are spending shareholder dollars and whether or not they are protecting the bottom line."

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