

## LEGAL ALERT

### Final NYSE and Nasdaq Rules on Compensation Committees and Advisers

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On January 11, 2013, the Securities and Exchange Commission approved final rules proposed by the NYSE<sup>1</sup> and Nasdaq<sup>2</sup> in response to SEC rules adopted in June 2012 that implemented Section 952 of the Dodd-Frank Act.<sup>3</sup> Both the NYSE and the Nasdaq rules address:

- The independence of compensation committee members;
- Compensation committee authority and responsibility for the appointment, compensation and oversight of advisers; and
- Compensation committee consideration of the independence of advisers.

#### Independence of Compensation Committee Members

Both the NYSE and Nasdaq rules<sup>4</sup> have added only the two new “independence” factors for compensation committee members that were required by the SEC rules:

- A director’s source of compensation, including any consulting, advisory or compensatory fee paid by the company (the Fees Factor); and
- Whether the director is affiliated with the company, a subsidiary or an affiliate of a subsidiary (the Affiliation Factor).

While the NYSE rules require only a consideration of the Fees Factor, Nasdaq’s rules will bar from the compensation committee any director who directly or indirectly receives any consulting, advisory or other compensatory fee (other, of course, than regular director and committee fees) from the listed company or any subsidiary, which is the same standard that has applied to audit committee members since the Sarbanes-Oxley Act.

As to the Affiliation Factor, both the NYSE and Nasdaq rules require only that it be considered, and their commentaries make clear that a member’s association with a large stockholder need not be considered an impediment to “independence.”

Nasdaq has taken the occasion to eliminate an alternate provision in its corporate governance rules that has permitted Nasdaq issuers to dispense with a compensation committee, if executive compensation is approved by a majority of the board’s independent directors, voting separately. Nasdaq issuers that had been relying on that

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alternative will have to establish a compensation committee of at least two members, with a charter covering specified matters, by the final compliance deadline discussed below.

### **Compensation Committee Engagement of Advisers**

Both the NYSE and Nasdaq rules state that (i) the compensation committee must have authority, but is not required to, retain or obtain the advice of one or more compensation advisers<sup>5</sup>; (ii) the compensation committee will be responsible for the appointment, compensation and oversight of services provided by advisers it retains; and (iii) the company must provide funding to compensate advisers retained by the committee. (NYSE rules already contained substantially similar requirements.)

### **Consideration of Independence of Advisers**

Both the NYSE and Nasdaq rules require consideration by the compensation committee only of the six “independence” factors specified by the SEC rules before the committee decides to engage or obtain advice from a compensation adviser:

- Other services to the company provided by the adviser’s firm;
- The amount of fees received from the company by the adviser’s firm, as a percentage of the firm’s total revenue;
- The firm’s policies and procedures designed to prevent conflicts of interest;
- Any business or personal relationship between the adviser and any member of the compensation committee;
- Any company stock owned by the adviser; and
- Any business or personal relationship between the adviser or his or her firm and an executive officer of the company.

Both rules state clearly that the committee is free to take advice from any adviser, whether independent or not. The compensation committee must, however, consider these factors when engaging both compensation consultants and outside legal advisers and also when receiving advice from consultants or legal advisers engaged by management. Advice provided by in-house legal staff is not covered. Also exempted is any adviser who consults only on broad-based plans or provides only non-customized information, which mirrors an exemption from the recently adopted proxy disclosure requirements as to conflicts of interest of compensation consultants.<sup>6</sup> These rules will require many law firms that advise compensation committees to provide information to public company clients that they have not provided before.

### **Compliance Deadlines**

The NYSE and Nasdaq have harmonized their compliance deadlines, adopting a two-step approach under which some requirements must be satisfied by July 1, 2013, and the others by the later of the company’s first annual meeting after January 15, 2014, or October 31, 2014 (Final Compliance Deadline). They differ, however, in which requirements must be satisfied by which deadline.

The NYSE rules require all requirements to be satisfied by July 1, 2013, other than the new compensation committee member independence requirements, to which the Final Compliance Deadline applies.

The Nasdaq rules require the provisions relating to authority of the compensation committee (or independent directors) to retain advisers and responsibility to consider the “independence factors” to be satisfied by July 1, 2013. The rules indicate that this need not be done through an amendment to the compensation committee charter by that date, however, if state law permits implementation by a board resolution. The other requirements, including new

committee member independence requirements, need to amend the compensation committee charter and, for those companies that have not had a compensation committee, establishment of the committee and adoption of a charter, are subject to the Final Compliance Deadline.

## Conclusion

All listed companies will need to take some action to reflect the new requirements by July 1, 2013, unless they have already done so. Compensation committee charter amendments, or for Nasdaq issuers at least a board resolution, with respect to the “authority” and “independence of advisers assessment” requirements are likely to be necessary, and “independence assessment” homework will be necessary as to any covered adviser who will be providing advice to the committee on or after July 1, 2013.

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## Endnotes

<sup>1</sup> <http://www.sec.gov/rules/sro/nyse/2013/34-68639.pdf>

<sup>2</sup> <http://www.sec.gov/rules/sro/nasdaq/2013/34-68640.pdf>

<sup>3</sup> The SEC release may be found at: <http://www.sec.gov/news/press/2012/2012-115.htm>. We summarized the SEC rules in our Bingham Alert dated June 25, 2012 that may be found at: <http://www.bingham.com/Alerts/2012/06/SEC-Adopts-Rules-on-Compensation-Committees-and-Advisers>.

<sup>4</sup> The rules apply only to issuers of listed equity securities and exempt smaller reporting companies (with a few exceptions), controlled companies, limited partnerships, companies in bankruptcy proceedings, registered investment companies and foreign private issuers that include in their annual reports reasons for not having an independent compensation committee.

<sup>5</sup> “Adviser” is construed broadly under the new rules to include not only compensation consultants, but also outside (but not internal) legal counsel.

<sup>6</sup> This disclosure requirement, adopted by the SEC release cited in note 3 above, applies to all companies subject to the proxy rules, including non-listed issuers, smaller reporting companies and controlled companies. It is in effect for all shareholder meetings at which directors are to be elected that take place on or after January 1, 2013.

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