OVERVIEW

On June 20, 2012, the Securities and Exchange Commission (“SEC”) adopted final rules (“SEC Rules”) to implement Dodd-Frank Act Section 952, requiring national securities exchanges to prohibit the initial or continued listing of any stock of a company that does not satisfy compensation committee independence criteria and compensation adviser independence criteria.

Under the SEC Rules (http://www.sec.gov/rules/final/2012/33-9330.pdf), each national securities exchange and national securities association must submit to the SEC, no later than 90 days after publication of the SEC Rules in the Federal Register, proposed rule change submissions (which the SEC must approve) to implement the listing standards.


COMPENSATION COMMITTEE MEMBER INDEPENDENCE

The SEC Rules do not include a uniform definition of “independence.” The SEC instructed the exchanges to establish their own independence criteria for members of compensation committees, as well as any other board committee which performs functions typically performed by a compensation committee, including oversight of executive compensation (in either case, “compensation committee”). In establishing their independence definitions, the exchanges are to consider “relevant factors” that must at a minimum include:

- The source of the board member’s compensation, including any consulting, advisory or other fees paid by the issuer; and
- Whether a board member is affiliated with the issuer or any subsidiary of the issuer.

The SEC left it to the exchanges to determine if any additional factors are to be included in their rules.

NYSE Proposed Rules

The NYSE Proposed Rules do not include any additional factors to be considered by the listed company board when making independence determinations under its independence standards. Likewise, the NYSE does not specifically exclude a board member from serving on the compensation committee because of an affiliate relationship with the listed company or its other affiliates. Rather, the NYSE Proposed Rules provide discretion to determine how consulting, advisory and other compensatory fees and affiliate status may affect a member’s independence. The NYSE Proposed Rules make clear that these factors should be considered as part of its affirmative determination of all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director’s ability to be independent from management in connection with the duties as a member of a compensation committee.

In making the independence assessments, the board will need to consider whether (a) the director receives compensation from any person or entity, including consulting, advisors and other fees paid by the listed
company, or (b) an affiliate relationship places the
director under control of the company or management,
or creates a relationship, which in either case could
impair the director’s independent judgment when
making independent compensation decisions.

**Nasdaq Proposed Rules**

The Nasdaq Proposed Rules similarly provide that
in addition to considering the affiliate status of
a director, the listed company board must also
consider whether such affiliation would impair the
director’s judgment as a member of the compensation
committee. The accompanying interpretive guidance
further states that the Nasdaq does not believe
that ownership of listed company stock by itself,
or possession of a controlling interest through
ownership of listed company stock by itself, precludes
a board finding that it is appropriate for a director to
serve on the compensation committee. The Nasdaq
Proposed Rules also specifically provide that it
may be appropriate for certain affiliates, such as
representatives of significant stockholders, to serve
on compensation committees since their interests
are likely aligned with those of other stockholders in
determining executive compensation.

However, unlike the NYSE Proposed Rules, the Nasdaq
Proposed Rules would impose a specific prohibition
on accepting directly or indirectly any consulting,
advisory or other compensatory fee from the listed
company, rather than making this one factor for
boards to consider in assessing independence (this
excludes director fees and retirement payments for
prior services with the entity).

The Nasdaq Proposed Rules would also no longer
allow compensation decisions to be made by a
majority of independent directors in lieu of having a
compensation committee (which had previously been
permitted). The Nasdaq Proposed Rules would require
companies to have a compensation committee with
at least two members, generally all of whom must be
independent directors. A non-independent director
could serve on the compensation committee under
certain limited circumstances if the compensation
committee consists of at least three members, and
the non-independent director is not an executive.
The Nasdaq Proposed Rules also include minimum
compensation committee charter requirements.

**COMPENSATION CONSULTANTS AND ADVISERS**

The SEC Rules require compensation committees to
take into consideration the following independence
factors when selecting, or obtaining advice from,
compensation advisers:

- The provision of other services to the issuer by
  the employer that employs the compensation
  adviser;
- The amount of fees received from the issuer by
  the employer that employs the compensation
  adviser, as a percentage of the employer’s total
  revenue;
- The policies and procedures of the employer
  that employs the compensation adviser that
  are designed to prevent conflicts of interests;
- Any business or personal relationship of the
  compensation adviser with a member of the
  compensation committee;
- Any stock of the issuer owned by the
  compensation adviser; and
- Any business or personal relationships
  between the issuer’s executive officers and
  the compensation adviser or the entity that
  employs the compensation adviser.

The SEC expressed its view that these six factors
should be considered in their totality but that no one
factor should be viewed as a determinative factor
of independence. However, the SEC Rules do not
indicate any materiality, numerical or other threshold
test. The exchanges may also consider other
independence factors in adopting their compensation
adviser independence listing criteria. The SEC chose
not to adopt specific materiality or numerical or other
bright-line thresholds with respect to such adviser
independence factors.
**NYSE Proposed Rules**

The NYSE Proposed Rules would adopt the six independence factors that compensation committees must consider with respect to the adviser’s independence from management when selecting a compensation consultant outside legal counsel (but not inside legal counsel) or other advisers to the compensation committee. The compensation committee is required to conduct this assessment with respect to those advisers that provide advice to the compensation committee.

The NYSE Proposed Rules also require the compensation committee to consider any other factors that would be relevant to the adviser’s independence from management, thus instructing the compensation committee to determine if there are additional pertinent factors to be taken into account.

**Nasdaq Proposed Rules**

The Nasdaq Proposed Rules would also adopt the six factors that compensation committees must consider with respect to the adviser’s independence that are in the SEC Rules without addition.

**TIMELINE**

**NYSE Proposed Rules**

The NYSE Proposed Rules generally take effect on July 1, 2013. NYSE-listed companies would have until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014 to comply with the independence standards.

**Nasdaq Proposed Rules**

The Nasdaq Proposed Rules relating to compensation committee responsibilities and relating to the (a) authority to retain compensation consultants, independent legal counsel and other compensation advisers; (b) authority to fund such advisers; and (c) responsibility to consider certain independence factors before selecting such advisers, other than in-house legal counsel, take effect immediately after adoption of the Nasdaq Proposed Rules by the SEC. The independence standards and specific charter requirements must be complied with by the earlier of either the second annual meeting held after the date of approval of the Nasdaq Proposed Rules or December 31, 2014. Nasdaq will require a certification as to compliance.