

Articles + Publications | January 22, 2013

# NYSE and NASDAQ Compensation Committee and Compensation Advisers Listing Standards

## Client Alert

### WRITTEN BY

Robert A. Friedel | David M. Kaplan | Randall I. Cherkas

---

Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) provides standards and disclosure requirements related to the independence of compensation committees and their retained advisors. To implement Section 952 of the Act, the Securities and Exchange Commission (SEC) issued final rules on June 21, 2012 directing national securities exchanges and associations (e.g., the New York Stock Exchange (NYSE) and NASDAQ) to adopt new listing standards. On January 11, 2013, the SEC approved NYSE and NASDAQ rule changes that were proposed in response to the SEC rules. The following is a brief description of the applicable SEC final rules and corresponding new NYSE and NASDAQ listing standards:

- **Compensation Committee Independence.** The SEC's final rules mandate that compensation committees will be required to include *only* "independent" directors. In determining an individual's independence, the applicable securities exchange or association is required to take into account relevant factors, including at least:
  - the sources of compensation for each compensation committee member, including any consulting, advisory, or other compensatory fee paid by the company, and
  - whether the compensation committee member is affiliated with the company, or a subsidiary or affiliate of the company.

The new NYSE and NASDAQ listing standards require boards to consider a director's compensation sources and affiliations, in addition to satisfying the stock exchanges' existing categorical independence standards.

The new NYSE and NASDAQ listing standards suggest that ownership of even a substantial amount of stock of the company by a compensation committee member may be beneficial, which is in contrast to the independence requirements for audit committee members, where material stock holdings of the company can bar a finding of independence.

Prior to the adoption of the new rules, the NYSE listing standards required listed companies to have a compensation committee comprised of independent directors, which determines and approves CEO compensation and which either approves or makes recommendations to the board with respect to non-CEO executive officer compensation, and no changes have been made to this aspect of the NYSE rules. Prior to the adoption of the new NASDAQ listing standards, applicable decisions or recommendations concerning CEO or non-CEO executive

officer compensation were required to be made either by a compensation committee comprised solely of one or more independent directors or by a majority of the independent directors of the board. The new NASDAQ rules now require that such decisions or recommendations be made by a compensation committee comprised solely of at least two independent directors.

- The new NYSE listing standards require boards to consider compensatory payments to compensation committee members (other than for board and committee service) and a member's affiliate status with the company when determining that member's "independence," without prohibiting compensatory payments or providing distinct prohibitions on stock ownership as it relates to affiliate status.
- The new NASDAQ listing standards prohibit compensatory payments to independent compensation committee members (other than director fees or deferred compensation payments from prior service at the company), but like the new NYSE listing standards, they provide flexibility with respect to stock ownership as it relates to affiliate status.
- **Hiring and Oversight of Compensation Consultants, Legal Counsel and Other Advisers to the Compensation Committee.** The SEC's final rules provide that before hiring or receiving advice from compensation advisers (e.g., compensation consultants, legal counsel and other compensation advisors), the compensation committee must consider their "independence." However, the new NYSE and NASDAQ listing standards both explicitly note that this requirement does not prohibit a compensation committee from selecting or receiving advice from compensation advisers that are not independent. The compensation committee is directly responsible for the appointment, compensation, and oversight of all compensation advisers.

Accordingly, in selecting a compensation adviser, the compensation committee must consider the following six "independence" factors:

- whether other services are provided to the company by the compensation adviser or entity that employs such advisor (the Consulting Firm)
- the amount of fees received from the company by the Consulting Firm, as a percentage of such entity's total revenue
- whether there are any policies of the Consulting Firm designed to prevent conflicts of interest
- whether the compensation adviser has any business or personal relationship with a member of the compensation committee
- whether the compensation adviser owns any company stock, and
- whether the compensation adviser or Consulting Firm has any business or personal relationship with a company executive officer.

Tracking a pre-existing exception to the requirement for proxy disclosure of a compensation consultant's role in determining or recommending the amount and form of executive and director compensation, a compensation committee is NOT required to conduct the independence assessment of a compensation adviser (see above) whose role is limited to:

- consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors, and that is available generally to all salaried employees, or
- providing information that either is not customized or that is customized based on parameters that are not developed by the adviser, and about which the adviser does not provide advice.
- **Compensation Consultant Disclosures.** Companies subject to the federal proxy rules are already required to disclose information about their use of compensation consultants, including specific information about fees paid to consultants in accordance with SEC regulations. However, the SEC final rules require that any company proxy or consent solicitation materials for an annual shareholder meeting occurring on or after January 1, 2013 must disclose:
  - whether the work of the compensation consultant raised any "conflicts of interest," and
  - if a "conflict of interest" is raised, the nature of such conflict and how it is being addressed.

While the SEC has not defined what would constitute a "conflict of interest," the final rules provide that the same six factors for considering compensation adviser independence (see above) should be considered in determining whether a "conflict of interest" exists.

- **Smaller Reporting Company Exception.** Smaller reporting companies (i.e., companies with less than \$75 million of public equity float) are exempt from (i) the new requirement to consider the independence of compensation advisors and (ii) the new rules requiring compensation committee members to comply with the heightened independence requirements over and above the pre-existing NYSE or NASDAQ categorical independence standards.
- **Effective Dates.** The new requirements described above mandating disclosure of conflicts of interest raised by the work of any compensation consultant are immediately effective. NASDAQ and NYSE rules on requiring compensation committees to evaluate a compensation adviser's independence will take effect on July 1, 2013. The enhanced NASDAQ and NYSE compensation committee independence requirements will apply on the earlier of a company's 2014 annual shareholder meeting or October 31, 2014.

If you have any questions regarding corporate governance or executive compensation implications of the new NYSE and NASDAQ listing standards, the compensation committee/compensation adviser independence requirements, or any other relevant issues, please contact the Pepper attorney you generally work with or one of the authors of this *Client Alert*.

Robert A. Friedel, David M. Kaplan and Randall I. Cherkas

*The material in this publication was created as of the date set forth above and is based on laws, court decisions, administrative rulings and congressional materials that existed at that time, and should not be construed as legal advice or legal opinions on specific facts. The information in this publication is not intended to create, and the transmission and receipt of it does not constitute, a lawyer-client relationship.*

## **RELATED INDUSTRIES + PRACTICES**

- Corporate
- Employee Benefits + Executive Compensation
- Securities Investigations + Enforcement