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Corporate Governance Group

Client Alert

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NYSE AND NASDAQ ISSUE PROPOSED RULES FOR COMPENSATION COMMITTEES

On June 20, 2012, in furtherance of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Securities and Exchange Commission adopted new Rule 10C-1 under the Securities Exchange Act of 1934 and amendments to Item 407 of Regulation S-K¹ that, among other things, focused on ensuring the independence of compensation committee members by directing the national securities exchanges to “establish listings standards that ... require each member of a listed issuer’s compensation committee to be ... ‘independent’ as defined in the listing standards of the exchange.” In response to this SEC release, each national securities exchange in late September proposed rule change submissions to comply with new Rule 10C-1.

The requirements of Rule 10C-1 and the proposed new listing standards of each of the NYSE and NASDAQ are summarized below. Once the exchanges’ final listing standards are approved, we will disseminate a comprehensive review updating this Client Alert.

| | Rule 10C-1 | NYSE Proposed Rules | NASDAQ Proposed Rules |
|--|--|--|---|
| <i>Committee Member Independence Standards</i> | <ul style="list-style-type: none"> Requires each member of a compensation committee to be “independent”, but the SEC rules neither define independence nor impose specific standards Directs exchanges to develop their own definitions after considering “relevant factors” including (i) “any consulting, advisory, or other compensatory fee paid by the issuer to [a] member” and (ii) whether any director “is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer” | <ul style="list-style-type: none"> In addition to its current requirements², when determining independence, the proposed rules would require a board to consider all relevant factors including the two new factors in Rule 10C-1 While neither Rule 10C-1 factor would preclude a director from being deemed independent, each new factor must be considered There would be no absolute prohibition on a director being deemed independent solely based on being an “affiliate” as a result of share ownership (which is seen as giving that director the same economic interests in ensuring that executive compensation is not excessive) | <ul style="list-style-type: none"> In addition to its current requirements³, when determining independence, the proposed rules would (i) prohibit any director from accepting directly or indirectly any consulting, advisory or other compensatory fees other than for board service (which is the same as Rule 10A-3 for audit committee members) and (ii) require a board to consider whether a director is affiliated with the Company There would not be a blanket prohibition regarding affiliated directors because certain affiliates (e.g., large stockholders) are likely aligned with other stockholders in seeking appropriate compensation programs |

¹ For a further discussion on the SEC’s adopting release for Rule 10C-1 and amendments to Item 407 of Regulation S-K, please see our Client Alerts entitled “SEC Adopts New Rules Requiring Stock Exchange Listing Standards For Compensation Committees” (June 27, 2012).

² When determining “independence” under its current listing standards, the NYSE rules (a) require a board to affirmatively determine that a director has no material relationship to the company and (b) provide that a director may not be independent if a relationship exists that would violate five “bright line” tests.

³ When determining “independence” under its current standards, the NASDAQ rules (a) require a board to affirmatively determine that a director does not have a relationship that would interfere with the exercise of independent judgment in carrying out that director’s responsibilities and (b) provide that certain categories of director, based on certain identified relationships, cannot be independent.

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| | Rule 10C-1 | NYSE Proposed Rules | NASDAQ Proposed Rules |
|--|--|--|---|
| <i>Committee Role</i> | <ul style="list-style-type: none"> N/A | <ul style="list-style-type: none"> N/A | <ul style="list-style-type: none"> While not required by Rule 10C-1, the proposed rules would require (i) a standing compensation committee comprised of at least two independent directors and (ii) adoption of a formal committee charter, subject to annual review⁴ |
| <i>Advisor Access and Independence</i> | <ul style="list-style-type: none"> Committee must have authority to retain or obtain advice of consultants, be directly responsible for overseeing and compensating its advisers, and be provided with appropriate funding While advisers are not required to be independent, committees must consider six independence factors before retaining an adviser (as well as any other factors identified by the applicable exchange) | <ul style="list-style-type: none"> Because the required powers of the compensation committee are in significant part already required by the NYSE's existing listing standards⁶, the NYSE did not propose any new listing standards in this regard The proposed rules adopt the SEC's six factor independence test without adding any new factors | <ul style="list-style-type: none"> The proposed rules would require the compensation committee to have responsibilities and authority necessary to comply with Rule 10C-1, including by requiring that the committee have the authority to retain and pay advisers The proposed rules adopt the SEC's six factor independence test without adding any new factors |
| <i>Effectiveness</i> | <ul style="list-style-type: none"> N/A | <ul style="list-style-type: none"> Proposed rules would not become operative until July 1, 2013 Companies would have until the earlier of their first annual meeting after January 15, 2014 or October 31, 2014 to comply | <ul style="list-style-type: none"> Rules pertaining to committee's authority to retain and pay advisers and the rule to consider the six factor independence test before retaining an adviser would be effective immediately following approval of final rules All other proposed rules would require compliance by the earlier of the second annual meeting held after approval of the final rules and December 31, 2014 |

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4 In adopting this approach under the proposed rules, NASDAQ is proposing to eliminate its alternative rule that permits a majority of independent directors, in lieu of having a standing compensation committee, determine executive compensation.

5 The six factors set forth in Rule 10C-1 include (i) the provision of other services to the company by the compensation committee adviser, (ii) the percentage of the adviser's total revenue that is represented by the fees received from the company, (iii) the policies and procedures of the adviser that are designed to prevent conflicts of interest, (iv) any business or personal relationship of the adviser with an executive officer, (v) any business or personal relationship of the adviser with a member of the compensation committee and (vi) any stock of the company owned by the adviser.

6 Significantly all of Rule 10C-1's requirements in this regard exist in the NYSE's compensation committee charter listing standards.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

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