

Milbank

# Corporate Governance Group

# Client Alert

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## NYSE AND NASDAQ ADOPT FINAL 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-K 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, on January 11, 2013, each national securities exchange adopted new listing standards to comply with new Rule 10C-1<sup>1</sup>.

The requirements of Rule 10C-1 and the new listing standards of each of the NYSE and NASDAQ are summarized below.

	Rule 10C-1	NYSE Adopted Rules	NASDAQ Adopted Rules
<i>Committee Member Independence Standards</i>	<ul style="list-style-type: none"> <li>Requires each member of a compensation committee to be “independent”, but the SEC rules neither define independence nor impose specific standards</li> <li>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”</li> </ul>	<ul style="list-style-type: none"> <li>In addition to its current requirements<sup>2</sup>, when determining independence, the new rules require a board to consider all relevant factors including the two new factors in Rule 10C-1</li> <li>While neither Rule 10C-1 factor will preclude a director from being deemed independent, each new factor must be considered</li> <li>There is 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)</li> </ul>	<ul style="list-style-type: none"> <li>In addition to its current requirements<sup>3</sup>, when determining independence, the new rules (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</li> <li>There is no blanket prohibition regarding affiliated directors because certain affiliates (e.g., large stockholders) are likely aligned with other stockholders in seeking appropriate compensation programs</li> </ul>

1 For a further discussion on (a) the SEC’s adopting release for Rule 10C-1 and amendments to Item 407 of Regulation S-K, please see our Client Alert entitled “SEC Adopts New Rules Requiring Stock Exchange Listing Standards For Compensation Committees” (June 27, 2012) and (b) the proposed rule releases for each national securities exchange, please see our Client Alert entitled “NYSE and Nasdaq Issue Proposed Rules for Compensation Committees” (October 18, 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 Adopted Rules	NASDAQ Adopted Rules
<i>Committee Role</i>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>The new rules do not modify the existing NYSE rules that currently require a listed company to have a compensation committee comprised entirely of independent directors and to adopt a formal written charter</li> </ul>	<ul style="list-style-type: none"> <li>While not required by Rule 10C-1, the new rules require (i) a standing compensation committee comprised of at least two independent directors and (ii) adoption of a formal committee charter, subject to annual review<sup>4</sup></li> </ul>
<i>Advisor Access and Independence</i>	<ul style="list-style-type: none"> <li>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</li> <li>While advisers are not required to be independent, committees must consider six independence factors<sup>5</sup> before retaining an adviser (as well as any other factors identified by the applicable exchange)</li> </ul>	<ul style="list-style-type: none"> <li>The new rules 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</li> <li>The new rules adopt the SEC's six factor independence test without adding any new factors or requiring that the adviser be independent (simply that an independence assessment be conducted)</li> <li>However, a compensation committee is not required to conduct an independence assessment of an adviser that acts in a limited role (e.g., consulting on any broad-based plan that does not discriminate in favor of executive officers or directors or providing non customized information)</li> </ul>	<ul style="list-style-type: none"> <li>The new rules 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</li> <li>The new rules adopt the SEC's six factor independence test without adding any new factors or requiring that the adviser be independent (simply that an independence assessment be conducted)</li> <li>However, a compensation committee is not required to conduct an independence assessment of an adviser that acts in a limited role (e.g., consulting on any broad-based plan that does not discriminate in favor of executive officers or directors or providing non customized information)</li> </ul>
<i>Effectiveness</i>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>Listed companies will have until the earlier of their first annual meeting after January 15, 2014 or October 31, 2014 to comply with the new compensation committee independence standards</li> <li>All other new rules will become effective on July 1, 2013 Proposed rules would not become operative until July 1, 2013</li> </ul>	<ul style="list-style-type: none"> <li>New 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 will be effective July 1, 2013</li> <li>All other new rules will require compliance by the earlier of the first annual meeting after January 15, 2014 or October 31, 2014</li> </ul>

4 In adopting this approach, NASDAQ has eliminated its alternative rule permitted 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.

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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