

SEC adopts new stock standards for 'independent' compensation committee members

New rules also require enhanced disclosures relating to compensation committee advisers

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In furtherance of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010¹, the Securities and Exchange Commission adopted June 20 new Rule 10C-1 under the Securities Exchange Act of 1934 and amendments to Item 407 of Regulation S-K.

New Rule 10C-1 focuses 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." The amendments to Regulation S-K Item 407 will require issuers to provide greater disclosure regarding their compensation committees' use of various compensation advisers as well as any conflict of interest arising from such use.

Each national securities exchange is required to provide to the SEC, no later than 90 days after publication in the Federal Register, proposed rule change submissions that comply with new Rule 10C-1, and have final

rules approved no later than one year after publication in the Federal Register. Issuers must comply with the disclosure changes in Item 407 of Regulation S-K in any proxy or information statement for a meeting of shareholders at which directors are elected that occurs on or after Jan. 1, 2013.

board of directors," and whether any director "is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer." The SEC emphasizes the considerable "discretion" and "flexibility" granted to the exchanges to set "their own minimum independence criteria for compensation

In the final rule, the SEC continues to clarify that compensation advice may be obtained from any compensation consultant, legal counsel or other advisers, regardless of whether they are independent.

COMPENSATION COMMITTEES

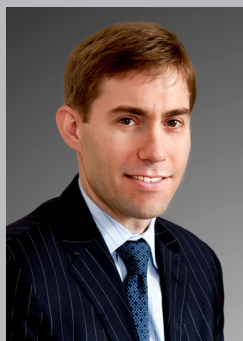
Rule 10C-1(b)(1)(i) requires that each member of a listed issuer's² compensation committee be an "independent" member of its board of directors. The adopted rule does not define independence, nor does it impose specific independence standards. Instead, the adopted rule directs the exchanges to develop their own definitions after considering "relevant factors," including "any consulting, advisory or other compensatory fee paid by the issuer to [a] member of the

committee members," particularly in contrast with the more stringent requirements of Exchange Act Section 10A(m) relating to audit committee independence under which, for instance, affiliated shareholders are conclusively deemed not to be independent.

COMPENSATION ADVISERS

Rule 10C-1(b)(2) directs the exchanges to prohibit the listing of any security of an issuer that does not provide its compensation committee with the authority to "retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser." The adopted rule also provides that the compensation committee shall be "directly responsible" for overseeing and compensating its compensation advisers. Further, to ensure adequate funds to compensate compensation committee advisers, the adopted rule states that listed issuers "must provide for appropriate funding, as determined by the compensation committee," for this purpose.

While Exchange Act Section 10C does not require that compensation committee advisers be independent, the adopted rule provides that the new listing standards should require that compensation committees



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consider the following independence factors before retaining a compensation adviser (as well as any other factors identified by the applicable exchange):

- The provision of other services to the issuer by the compensation committee adviser.
- The percentage of the compensation committee adviser's total revenue that is represented by the fees received from the issuer.
- The policies and procedures of the compensation committee adviser that are designed to prevent conflicts of interest.
- Any business or personal relationship of the compensation committee adviser with the issuer's executive officers.
- Any business or personal relationship of the compensation committee adviser with a member of the compensation committee.
- Any stock of the issuer owned by the compensation committee adviser.

OPPORTUNITY TO CURE DEFECTS

Adopted Rule 10C-1(a)(3) requires the exchanges to establish procedures affording issuers the "reasonable opportunity to cure any defects" that will result in delisting of an issuer's securities as a result of failure to comply with the compensation committee listing standards.

The adopted rule also allows individual compensation committee members to cure violations of the independence requirements

while remaining on the committee until the earlier of the issuer's next annual meeting or one year from the event that caused the independence violation.

EXEMPTIONS

Consistent with Section 10C, adopted Rule 10C-1(b)(1)(iii) provides various exempt categories of issuers, including "controlled companies," companies in bankruptcy and any foreign private issuer that provides annual disclosures to its shareholders as to why it does not have an independent compensation committee. The adopted rule also authorizes the exchanges to exempt from their independence requirements certain relationships of their choosing between compensation committee members and the issuers. Finally, consistent with the mandate of the Dodd-Frank Act, the exchanges will be permitted to consider exemptions for both issuers and their compensation committee members "taking into account the size of an issuer."

NON-INDEPENDENT ADVISERS CONTINUE TO BE PERMISSIBLE

In the final rule, the SEC continues to clarify that compensation advice may be obtained from any compensation consultant, legal counsel or other advisers, regardless of whether they are independent. However, in selecting such a consultant, counsel or other adviser, the committee must consider the six independence factors listed above. As discussed below, disclosure will be required regarding the independence of consultants who are involved in recommending the amount or form of executive compensation.

AMENDMENTS TO ITEM 407 OF REGULATION S-K

Item 407 of Regulation S-K requires registrants that are subject to the Exchange Act proxy rules to provide various disclosures concerning their compensation committees and the use of compensation consultants. Currently, if a compensation consultant plays any role in determining or recommending the amount or form of executive or director compensation, Item 407 requires disclosure as to:

- The nature and scope of the consultant's assignment.
- The material elements of any instructions given to the consultants under the engagement.
- Disclosure regarding the aggregate fees paid to a consultant for advice or recommendations on the amount or form of executive and director compensation.

The amendment to Item 407 will expand this disclosure to also require disclosure of the nature of any conflict raised by a compensation consultant's work and how the conflict is being addressed. Such disclosure will be required only for proxy and information statements for meetings at which directors are to be elected.

Item 407, however, will not require disclosure if a consultant only provides advice on "broad-based plans" or provides only "non-customized benchmark data." [WJ](#)

NOTES

¹ For a further discussion of the Dodd-Frank Act, please see our Client Alerts titled "Corporate Governance Highlights of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010" (July 21, 2010); "Accredited Investor Standard for Reg D Offerings Tightened by Wall Street Reform Act" (Aug. 4, 2010); "SEC Adopts Long-Awaited Proxy Access Rules" (Sept. 14, 2010); "SEC Adopts New Rules for Shareholder 'Say on Pay' Votes on Executive Compensation and Golden Parachutes" (Feb. 10, 2011); "SEC Staff Issues Guidance on Shareholder 'Say on Pay' Voting" (Mar. 8, 2011)

² Rule 10C will apply only to issuers with listed "equity" securities and not, as in the case of the SEC's audit committee rules, issuers with listed debt securities.



REUTERS/Jonathan Ernst.