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*EXEQUITY*

Independent Board and Management Advisors

## *Client Alert*

# NYSE and NASDAQ Propose Changes to Implement SEC's Final Rules on Independence of Compensation Committees and Their Advisers

On September 25, 2012, the New York Stock Exchange (the "NYSE") and, on September 26, 2012, the NASDAQ Stock Market ("NASDAQ") filed proposed changes[1] to their rules for listed companies with the Securities and Exchange Commission (the "SEC"). The NYSE and NASDAQ proposed rule changes are intended to implement the final rules the SEC passed in June 2012 to comply with the provisions of Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10C to the Securities Exchange Act of 1934.

### NYSE Proposals

Generally, the final rules adopted by the NYSE merely mirror the final rules released by the SEC,[2] with some minor clarifications as to timing. For a summary of the SEC final rules, please see Exequity's *Client Alert*, "SEC Issues Final Rules on Independence of Compensation Committees and Their Advisers" (July 10, 2012).[3]

#### *Timing*

*General Timing*

The NYSE indicates that the changes to its Listed Company Manual will not become effective until July 1, 2013.

However, listed companies will not have to comply with the amended Listed Company Manual provisions related to compensation committee independence until the **earlier of** (i) their **first annual meeting after January 15, 2014** or (ii) **October 31, 2014**.

[1] See NYSE Notice, File No. SR-2012-49, filed with the SEC on September 25, 2012, available at: http://www.nyse.com/nysenotices/nyse/rule-filings/pdf;jsessionid=474035BE3B197D71B5150C5D1911BB0F?file_no=SR-NYSE-2012-49&seqnum=1, as subsequently amended on October 1, 2012 in Amendment No. 1 to clarify that companies will have until the earlier of their first annual meeting after January 15, 2014 or October 31, 2014 to comply with the new director independence requirements with respect to compensation committees, while the other proposed changes will become effective on July 1, 2013, available at: http://www.nyse.com/nysenotices/nyse/rule-filings/pdf?file_no=SR-NYSE-2012-49&seqnum=2; and NASDAQ Notice, File No. SR-2012-109, filed with the SEC in September 26, 2012, available at: http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2012/SR-NASDAQ-2012-109.pdf

[2] See SEC Press Release 2012-115, June 20, 2012, http://www.sec.gov/news/press/2012/2012-115.htm; SEC Release Nos. 33-9330; 34-67220; File No. S7-13-11, available at: http://www.sec.gov/rules/final/2012/33-9330.pdf

[3] Available on Exequity's website at: http://www.exqty.com/Media/Publications/SEC%20Final%20Rules%20CC%20Independence_20120710.pdf

### *Newly Listed Companies*

Newly listed companies will still be eligible for a transition period before they will be required to fully comply with these new requirements. During the transition period, a company must have at least one independent director on its compensation committee by its listing date, at least a majority of independent directors on the compensation committee within 90 days of the listing date, and a fully independent compensation committee within one year of the listing date.

### *Smaller Reporting Companies*

The NYSE also proposes to exempt smaller reporting companies from complying with these new independence requirements for compensation committees. Under a newly proposed transition period, companies that ceased to be “smaller reporting companies” would be required (if other exemptions do not apply) to (i) have a completely independent compensation committee within six months and (ii) immediately comply with the requirements concerning the compensation committee’s consideration of compensation consultant’s independence from management.

## NASDAQ Proposals

The NASDAQ proposals are a bit more extensive than those of the NYSE, primarily because NASDAQ also implemented some provisions that the NYSE rules already addressed, e.g., requirement for a compensation committee and a written compensation committee charter.

### ***Compensation Committees***

NASDAQ revised its rules to require listed companies to satisfy their obligations with respect to executive compensation through the use of a compensation committee made up of at least two independent directors. Previously, NASDAQ had permitted such obligations to be carried out by all independent directors in lieu of through a compensation committee. NASDAQ would continue to permit a non-independent director to serve on the compensation committee in exceptional and limited circumstances if the committee consists of three directors and the non-independent director is not a company executive.

### ***Independence of Compensation Committee Members***

NASDAQ decided to look to its existing rules for audit committee member independence in developing the independence standards for compensation committee members. Consequently, compensation committee members will be covered by the same audit committee member prohibitions on accepting, directly or indirectly, any consulting, advisory, or other compensatory fees from the company. But boards can consider the affiliated relationships of compensation committee members without such relationships being a complete bar to committee membership as is the case with audit committee members. Boards will have to determine whether the affiliation would impair a member’s judgment. NASDAQ pointed out in several examples that a number of affiliated directors would possibly be good members of the compensation committee, e.g., those affiliated with significant shareholders.

### ***Written Charter for Compensation Committees***

NASDAQ-listed companies will now have to certify that they adopted a formal, written compensation committee charter. The charter must include (i) the scope of the committee’s responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements; (ii) the committee’s responsibility for determining, or recommending to the board for determination, the compensation of the chief executive officer and all other executive officers; (iii) that the chief executive officer may not be present during voting or deliberations by the committee on his or her compensation; and (iv) the committee’s responsibilities and authority with respect to (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. Companies will be required to review and reassess the adequacy of the compensation committee's charter annually.

### *Independence of Compensation Committee Advisers*

NASDAQ, like the NYSE, decided to only have companies consider the six independence factors listed in Rule 10C-1. Further, NASDAQ specified that companies are not required to retain independent compensation advisers; they need only consider the six independence factors set out in Rule 10C-1 before selecting a compensation adviser.

### *Exemptions*

NASDAQ proposes to provide an exemption from compliance with its revised rules regarding compensation committees to asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies, and controlled companies. Foreign Private Issuers also can choose not to comply with these revised compensation committee rules if they follow their home country practice, but will be required to disclose this fact and the reasons why it does not have a compensation committee.

### *Timing*

#### *General Timing*

Effective immediately, NASDAQ-listed companies will be subject to the rules related to the requirement that a compensation committee must have specific authority and responsibilities to comply with Rule 10C-1(b)(2), (3), and (4)(i)-(iv) relating to the (i) authority to retain compensation advisers; (ii) authority to fund such advisers; and (iii) responsibility to consider certain independence factors before selecting such advisers, other than in-house legal counsel. Companies must certify to NASDAQ within 30 days after the implementation of these amended rules that they have complied with these requirements regarding compensation committees.

Companies must comply with the remaining provisions of the rules regarding compensation committees by the earlier of (i) their second annual meeting held after the date of approval of NASDAQ's amended listing rules or (ii) December 31, 2014. Companies must certify compliance with these rules by the applicable deadline with NASDAQ.

#### *Newly Listed Companies*

Newly listed companies can phase in compliance with the compensation committee requirements as follows: (i) one independent member on the committee at the time of listing; (ii) a majority of independent members within 90 days of listing; and (iii) all independent members within one year of listing.

#### *Smaller Reporting Companies*

Smaller reporting companies will not be required to follow the new requirements regarding compensatory fees and affiliation or to incorporate language specifying the committee's responsibilities and authority regarding compensation advisers into their formal written compensation committee charter or board resolution. Smaller reporting companies will be required to have a compensation committee consisting of at least two independent directors and adopt a formal, written charter for their compensation committee.

***Exequity Comments****: Unfortunately, as we expected neither the NYSE nor NASDAQ took the opportunity to expand on the final rules issued by the SEC regarding the independence of compensation committees and their advisers. That said, NASDAQ did expand its independence criteria beyond that of NYSE when it chose to generally follow its audit committee independence requirements with certain modifications. However, both NYSE and NASDAQ simply referred to the list of independence factors to be considered by a compensation committee when deciding to engage a compensation adviser. They both also made clear that in keeping with the SEC final rules, there is no requirement for companies to engage the services of an independent compensation adviser. We wonder if this will end up developing more along the lines of U.K. practice where shareholders and/or the SEC ultimately encourage companies to explain why they did not engage the services of an independent compensation adviser. As a practical matter, this portion of the rules likely will have very little impact on companies as many have already engaged the services of independent compensation advisers. The most significant change from these proposals will fall on NASDAQ-listed companies which will now be required to have a formal, written compensation committee charter. Many such companies had already adopted compensation committee charters having recognized it as a best practice, but even they will need to review their charters to determine if they fully comply with the new NASDAQ requirements.*

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