

Publications

Securities Alert: New SEC Rule and Disclosure Requirements Adopted Governing Compensation Committees

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On June 20, 2012, the Securities and Exchange Commission (SEC) adopted a new final rule and amendments to current proxy disclosure rules regarding compensation committees. The new rule implements compensation committee listing requirements. The amendments add to the current disclosure requirements concerning compensation advisers utilized by compensation committees. The new rule and amendments implement 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 (the Exchange Act). A complete copy of the adopting release (SEC Release No. 33-9330) can be accessed at www.sec.gov/rules/final/2012/33-9330.pdf.

New Rule 10C-1 – Listing standards relating to compensation committees.

The new rule, adopted as Exchange Act Rule 10C-1, directs stock exchanges to establish listing standards that require each member of a listed issuer's compensation committee to be an "independent" member of the board of directors. The new rule does not require a listed company to formally designate a compensation committee; however, in the absence of a designated compensation committee, the listing standards must apply to the directors, or group or committee of directors, who oversee executive compensation matters.

As in other instances, the SEC generally defers to the specific definition of "independent" to be adopted in the listing standards of the applicable stock exchange. In determining its individual requirements for an "independent" director, the new rule requires that each stock exchange consider certain "relevant factors," including, but not limited to:

- The source of compensation of a board member, including any consulting, advisory or other compensatory fee paid by the issuer to such board member; and

- Whether a board member is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

The new rule allows each stock exchange to consider the size of the issuer and any other relevant factors in determining whether to exempt certain issuers from the compensation committee independence requirements. The new rule specifically exempts certain types of issuers from the independence requirements:

- Limited partnerships;
- Companies in bankruptcy proceedings;
- Open-end management investment companies; and
- Any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.

The new rule reiterates that the listing standards adopted must provide compensation committees with the authority to retain compensation consultants or advisers, as well as legal counsel. The listing standards need not require that compensation committees retain or obtain advice only from independent consultants, advisers or counsel. However, the listing standards must require a compensation committee to conduct an "independence assessment" before obtaining such advice, which assessment must include consideration of the following factors, as well as any others prescribed by the relevant stock exchange:

- The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;
- The amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;
- The policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;
- Any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee;
- Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser; and
- Any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the issuer.

In adopting new listing standards, each stock exchange must provide appropriate procedures for a reasonable opportunity to cure in the event that a listed issuer becomes non-compliant. In addition, the listing standards must require each listed issuer to provide for appropriate funding to pay reasonable compensation to any consultants, advisers or counsel retained by the compensation committee.

Each stock exchange must provide the SEC with the exchange's proposed listing standards no later than 90 days after publication of new Rule 10C-1 in the Federal Register, and must have final listing standards that comply with Rule 10C-1 approved by the SEC within one year of such publication.

Smaller reporting companies and controlled companies (defined as listed issuers with more than 50 percent of the voting power for the election of directors held by an individual, a group or another company) are exempt from the requirements of the new rule.

Amendment to Item 407 of Regulation S-K regarding disclosure of use of compensation consultants and related conflicts of interest.

The SEC amendment adds new subparagraph (e)(3)(iv) to Item 407 of Regulation S-K. Item 407(e)(3)(iii) currently requires discussion of the role of any compensation consultants in determining or recommending the amount or form of executive or director compensation. New subparagraph (e)(3)(iv) requires the disclosure of any conflict of interest between the issuer and any such compensation consultant, regardless of whether the compensation consultant was retained by management, the compensation committee or any other board committee. The required disclosure must include a discussion of the nature of the conflict as well as a discussion of how the conflict is being addressed.

New subparagraph (e)(3)(iv) will apply to issuers subject to the SEC's proxy rules, including controlled companies, non-listed issuers and smaller reporting companies.

Issuers must comply with the amended disclosure requirements in Item 407 of Regulation S-K in any proxy statement for an annual meeting of shareholders at which directors will be elected occurring on or after January 1, 2013.