
SEC Adopts Independence Rules for Compensation Committees and Their Advisers

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In implementing Section 952 of the Dodd-Frank Wall Street Reform and Protection Act of 2010, the Securities and Exchange Commission (SEC) adopted final rules requiring national securities exchanges to adopt listing standards regarding the independence of compensation committee members, the committee's retention of compensation advisers, the committee's consideration of the independence of any advisers and the disclosure of any conflicts of interest of any advisers.

The securities exchanges have 90 days to propose amended listing standards for SEC approval and final amended listing standards must be in place within one year. It is possible that amended listing standards could be in place for next year's proxy season. In any case, new compensation consultant disclosure requirements will be required for proxy statements related to any annual or special meeting of shareholders at which directors will be elected occurring on or after January 1, 2013.

Compensation Committee Member Independence

The final rules require that compensation committee members be a member of the board of directors and independent as independence is defined by the securities exchanges. The securities exchanges are to consider certain factors in proposing their amended listing standards including, but not limited to, the source of compensation of a director and whether a director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company. The securities exchanges may turn these considerations into prohibitions but are not required to. Each securities exchange will establish its own definition of independence; however, the independence requirements are subject to review and final approval by the SEC. The rules do not require establishment of a formal compensation committee unless otherwise required by the applicable securities exchange. Included in the compensation committee definition is any board committee performing duties typically performed by a compensation committee, or in the absence of any such committee, the directors who oversee executive compensation matters on behalf of the board.

Adviser Independence

Securities exchanges must adopt listing standards providing that a compensation committee may, in its sole discretion, hire or obtain advice from compensation consultants, legal counsel and other advisers and be directly responsible for the appointment, compensation and oversight of any work of those consultants and advisers. Listed companies must also provide adequate funding for payment of any compensation adviser, legal counsel or other adviser retained by the compensation committee.

While the final rules do not require compensation committees to engage only independent advisers, they require that the following independence factors be considered prior to hiring a compensation consultant:

- Other services the compensation consultant is providing to the company;
- What fees the compensation consultant has received from the company for its services as a percentage of the consultant's total revenue;
- The policies and procedures the compensation consultant has adopted to prevent conflicts of interest;
- Any business or personal relationships the compensation consultant has with a member of the compensation committee;
- Any business or personal relationships the compensation consultant has with an executive officer; and
- Any stock ownership in the company by the compensation consultant.

Similar factors are to be considered when hiring legal counsel or other advisers.

The securities exchanges may require additional factors for consideration. However, the compensation committee does not need to consider such factors before consulting in-house counsel or consultants hired by management, including outside counsel, nor is it responsible for their oversight. According to the rules, the compensation committee does not have to hire any compensation advisers or follow the recommendations provided by the compensation advisers.

Disclosure Regarding Compensation Consultants

In addition to the current disclosure requirements in the annual proxy statement regarding a compensation consultant's role in determining director or executive compensation, the final rules require proxy statement disclosure of any conflicts of interest of any compensation consultant and a discussion of how that conflict is being addressed. While the rules do not define "conflicts of interest," they suggest considering the same factors regarding compensation consultant independence. These disclosures must be included in any proxy statement relating to an annual or special meeting of shareholders at which directors will be elected occurring on or after January 1, 2013.

Exemptions

Limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act of 1940 and foreign private issuers that disclose in their annual report the reasons why they do not have an independent compensation committee are exempt from the compensation committee member independence requirements but not from the compensation committee adviser requirements. Controlled companies and smaller reporting companies are exempt from the requirements of the new listing standards for compensation committees, however, those companies are

still subject to the consultant conflicts of interest disclosure. In addition, the securities exchanges may choose to exempt other categories of companies.

What This Means For Listed Companies

Listed companies should follow the development of final listing standards by the applicable securities exchange to ensure continued compliance. Depending on the final listing standards, listed companies may need to adjust their compensation committee membership or compensation committee charters. Unless exempted, listed companies must comply with the disclosure changes in Item 407 of Regulation S-K relating to conflicts of interest of compensation consultants in any proxy statement for an annual or special meeting of shareholders for the election of directors occurring on or after January 1, 2013.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or the authors below.

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