

SEC Releases Final Rules on Compensation Committee & Adviser Independence

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On Wednesday, June 20, 2012 the SEC released the final rules on Section 952 (Section 10C) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which addresses both Compensation Committee Independence and the use of outside advisers. The final rules are very much in-line with the proposed rules that were released. There were two notable changes from the proposed rules:

- **Factors to Consider in Assessing Adviser Independence:** In addition to the five factors (listed later) that must be considered when assessing a compensation adviser's independence originally included in the Dodd-Frank legislation and the proposed rules, the committee must also consider any relationships the adviser may have with an executive officer (proposed rules only required assessment of relationships with committee members)
- **Applicability of Committee Independence:** The proposed rules only addressed the independence of the members of the Compensation Committee; however, the final rules also specify that the requirements apply to all Board members who are acting in a fashion similar to the Compensation Committee
 - This may be of particular relevance when significant compensation decisions are made by the full board. Companies will need to be cognizant of what Directors may or may not vote on specific compensation issues.

TIMING FOR IMPLEMENTATION

The new rules and amendments will take effect 30 days after publication in the Federal Register. The stock exchanges have 90 days from the date the rules are effective to propose listing standards and one year from the date of effectiveness to have final rules in place. In addition, companies must be in compliance with the new required disclosure regarding the use of a compensation consultant (including whether the work of the compensation consultant has raised any conflicts of interest and if so, how the conflict is being addressed) for the proxy material for any annual meeting at which directors are elected on or after January 1, 2013.

In the section below, we provide a brief summary of highlights of the adopted rules.

COMMITTEE INDEPENDENCE

The listing standards must require that each member of a company's compensation committee be independent. The definition of independent is left to each of the exchanges to define, but needs to consider relevant factors, including:

- A director's source of income, including any compensatory arrangement with the company

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- Whether a director is affiliated with the company or any related entity

The rules do provide the exchanges flexibility to exempt particular relationships from the independence requirement, as deemed appropriate by the exchanges, if warranted by relevant factors (e.g., size of company).

COMPENSATION ADVISERS

The final regulations also direct the exchanges to establish listing standards related to compensation advisers (e.g., consultants, legal counsel, etc.), they specify the following:

- Each compensation committee must have the authority, in its sole discretion, to obtain the advice of compensation advisers
- Before selecting any compensation adviser, the compensation committee must take into consideration specific factors identified by the Commission that affect the independence of compensation advisers, though there are no specific thresholds or tests specified. The six factors are:
 1. Does the adviser's firm provide any other services to the company
 2. The fees received by the adviser as a percent of the adviser's total revenue
 3. The policies and procedures the adviser firm has in place to prevent conflicts of interest
 4. Any business or personal relationship between an adviser and the compensation committee
 5. Whether the adviser owns stock in the company
 6. Any business or personal relationship between the adviser and executive officers
- The compensation committee must be directly responsible for the appointment, compensation and oversight of the work of the advisers
- Sufficient funding must be provided to pay the adviser

Note the rules do not limit the exchanges from adding additional criteria to the assessment of adviser independence. It is also worth pointing out that the adopted rules do not require Committee's to use an independent adviser, but only to assess the independence of the adviser. The adopted rules also clarify that in using the advice of in-house legal counsel, the Committee does not have to consider the independence factors.

DISCLOSURE OF CONSULTANT INDEPENDENCE AND CONFLICTS OF INTEREST

As mentioned earlier, for any consultant that played a role in determining or recommending the amount or form of executive and director compensation and whose work has raised any conflict of interest, the companies will be required to disclose the nature of the conflict of interest and what the company did to address the conflict. This disclosure does not eliminate any of the currently required disclosure regarding executive compensation consultants (e.g., identify consultant, state whether consultant was engaged directly by the compensation committee, describe the nature and scope of the engagement and instructions given to the consultant, and fee disclosure if the consultant provided additional fees greater than \$120,000)

CONCLUSION

The adopted rules adhere closely to the original language of the Dodd-Frank legislation and to the proposed rules. The next step in the process of implementation will be in the exchanges' development of the listing standards. The adopted rules provide the exchanges with a good degree of flexibility in how they will define independence and the factors to consider in assessing independence. It will be interesting to see if they do much beyond what is laid out in the adopted rules to clarify the rules.

Please contact us at (212) 921-9350 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at www.capartners.com for more information on executive compensation.