

LEGAL UPDATES AND NEWS

2013 Proxy Season: New Compensation Committee and Adviser Independence Rules Require Action Now

For the 2013 proxy season (and thereafter), all SEC reporting companies will need to comply with new disclosure requirements with respect to compensation consultants. In addition, recently adopted Nasdaq and NYSE rules will require listed issuers (that are not smaller reporting companies) to comply with new compensation committee and compensation advisor requirements. While there are nuances between the NYSE and Nasdaq rules, each generally requires:

- Enhanced “independence” requirements applicable to the members of the compensation committee (*Beginning with the 2014 annual meeting*);
- Expanded requirements as to the powers and duties of the compensation committee (*Effective July 1, 2013*);
- An assessment of the “independence” of all compensation consultants, legal counsel, and advisers before engagement and periodically thereafter (*Effective July 1, 2013*); and
- Proxy disclosure of any conflicts of interest with compensation consultants (but not with legal counsel or other advisers) (*Currently effective*).

This newsletter summarizes the new rules and steps that public companies should take now for the 2013 proxy season.

Background

As required by Section 952 of the Dodd-Frank Act, which added Section 10C to the Securities Exchange Act, in June 2012 the SEC adopted new proxy disclosure rules for SEC reporting companies, and directed the securities exchanges to adopt rules requiring exchange listed companies to comply with Section 10C’s compensation committee and compensation adviser requirements. In September 2012, the NYSE, Nasdaq, and other stock exchanges issued proposed amendments to their listing standards to incorporate the Section 10C requirements. The SEC recently approved these new listing standards.

Independent Compensation Committees

Under Nasdaq’s amended rules, an issuer is required to have a compensation committee consisting of at least two independent directors, and the committee must have a formal written charter that must be reviewed annually. Nasdaq did not previously require listed companies to have a separate compensation committee. Most community banks already have a compensation committee with a charter, so this should not be a major change. As mandated by SEC Rule 10C-1, the NYSE and Nasdaq rules require that the compensation committee be comprised solely of “independent” directors and that the full board of directors make an affirmative determination that each member of the compensation committee is “independent.” Under SEC Rule 10C-1, this determination must consider (1) whether the director is affiliated with the company or any of its affiliates or subsidiaries; and (2) any compensation received by the director as consulting, advisory or other fees from the company, as well as other factors. The Nasdaq rule provides that a compensation committee director is not independent if he/she receives any consulting, advisory or other compensatory fees from the issuer. Both exchanges provide for a cure period for failure to comply with the compensation committee composition requirements due to one vacancy, or if one member ceases to be independent due to circumstances beyond the members’ reasonable control. Compliance must be regained by the earlier of the next annual shareholders’ meeting or one year from the event that caused the noncompliance. (*Effective beginning with the 2014 annual meeting*)

The annual D&O questionnaire should be updated to include questions relating to the new independence requirements (or a supplemental questionnaire should be provided to directors).

The new rules also require a compensation committee to have authority, in its sole discretion, to retain or obtain the advice of a compensation consultant, legal counsel or other adviser. In other words, the committee may hire (but is not required to hire), its own advisers. The compensation committee is directly responsible for the appointment, compensation and oversight of the work performed by outside experts engaged by it. An issuer is required to provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to such outside advisers to the committee. However, the rules do not require the compensation committee to follow the recommendations of experts, since the committee must continue to exercise its own judgment in fulfilling its fiduciary duties. *(Effective July 1, 2013)*

Independence of Compensation Consultants, Legal Counsel and Advisers

Before a compensation committee selects a compensation consultant, legal counsel or other adviser, the committee must consider the following six factors with respect to whether the adviser is “independent”:

- Whether the adviser’s employer provides other services to the issuer;
- The amount of fees received from the issuer by the adviser’s employer as a percentage of its total revenue;
- The policies and procedures of the adviser, adviser’s employer or legal counsel, that are designed to prevent conflict of interest;
- Business or personal relationships between the adviser and committee members;
- The adviser’s holdings of the issuer’s stock; and
- Business or personal relationships between the executives of the issuer and the adviser or adviser’s employer.

To comply with the new rule, the compensation committee should ask its compensation consultants, legal counsel and other advisers to confirm (in writing) their “independence” under each of these six factors. The independence assessment is not required as to an adviser whose role is limited to (i) consulting on a broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors, and is generally available to all salaried employees, and/or (ii) providing information that either is not customized for a particular company or is customized based on parameters that are not developed by the adviser and about which the adviser does not provide advice. *(Effective July 1, 2013)*

Proxy Disclosure of Conflicts of Interest with Compensation Consultants (Not Legal Counsel)

For this proxy season, issuers are also required to disclose whether a compensation consultant or its affiliates provided additional services to the issuer or its affiliates in an amount in excess of \$120,000. For any compensation consultant whose work has raised any conflict of interest based on the six factors set forth above (and any other factors the compensation committee considers relevant), a company must disclose in its proxy statement the nature of the conflict and how the conflict is being addressed. Note that the proxy disclosure requirement does not apply to any perceived conflict of interest involving legal counsel since lawyers are subject to state ethics and licensing rules that govern conflicts of interest. Somewhat similar rules apply to accounting firms. *(Currently effective)*

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If you would like to learn more about the new independence rules, please contact one of the following attorneys of our firm.

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