

# Small Business Securities Bulletin

A periodic bulletin keeping small businesses informed about current developments in securities law and related matters



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## SEC Adopts Final Rules on Listing Standards for Compensation Committees and Compensation Adviser Disclosure, Exempts Smaller Reporting Companies

On June 21, 2012, the Securities and Exchange Commission (SEC) adopted its final rules to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which added Section 10C to the Securities Exchange Act of 1934. Section 10C requires the SEC to adopt rules (i) directing the national securities exchanges and national securities associations (Exchanges) to prohibit listing equity securities of any company not in compliance with that Section's compensation committee (or any committee that performs typical compensation committee functions where there is no designated compensation committee) and compensation adviser requirements, and (ii) requiring additional disclosure regarding a compensation committee's retention of compensation consultants, as further discussed below. Consistent with the discretion Section 952 afforded the SEC, the final rule exempts smaller reporting companies (i.e. those with a public float below \$75 million) from the new listing standards (though not the SEC's disclosure rule). The Exchanges have until September 25, 2012 to submit their proposed rule changes to the SEC, and such rules must be finalized by June 27, 2013.

## Compensation Committee Listing Standards

New Rule 10C-1 directs the Exchanges to establish listing standards that, among other things, require each member of a listed company's compensation committee to be "independent" under a higher independence standard than the general board independence standard that currently applies to compensation committee members. In this regard the new rule, consistent with Section 10C, directs the Exchanges to consider "relevant factors," including a director's source of compensation paid by the company (including advisory and consulting fees) and whether a director is affiliated with the company or any subsidiary or affiliate of a subsidiary of the company, but does not otherwise specify the factors that the Exchanges must consider in formulating their rules, leaving it up to the Exchanges to develop the specifics of their independence definition for compensation committee members. These considerations are similar to the independence requirements for audit committee members put in place by the Sarbanes-Oxley Act of 2002 (SOX), although unlike the mandatory provisions of SOX, Section 10C only requires the Exchanges to consider these factors in setting their independence standards for compensation committee members, so it is possible the compensation committee independence requirements implemented by the Exchanges may not be as rigorous as those that apply to audit committee members which, for example, entirely prohibit a company's payment of consulting or advisory fees to audit committee members. Therefore, we will not know what standards will actually apply to listed companies' compensation committee members until the Exchanges propose and finalize their rules, which the SEC must review and approve, in accordance with Rule 10C-1.

In addition, and again similar to the audit committee provisions of SOX, the Exchanges' rules must provide that (i) the compensation committee may, in its sole discretion, retain or obtain the advice of compensation advisers or independent legal counsel, (ii) the compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser or counsel it retains, and (iii) the listed company must provide for appropriate funding for payment of reasonable compensation, as determined by the compensation committee, to compensate any such advisers/counsel. While the final rule does not prohibit a listed company's compensation committee from retaining or seeking advice from advisers that are not independent, such as company counsel or other advisers retained by management, the committee may do so only (except with respect to in-house counsel) after considering certain factors relating to independence, including the adviser's provision of other services to the company and the fees such adviser's firm has received from the company, the adviser's firm's policies designed to prevent conflicts of interest, any business or personal relationships between the adviser and compensation committee members and executive officers, and the adviser's (and their immediate family members') ownership of company stock. The Exchanges may add additional independence factors in their rules implementing Rule 10C-1.

In addition to exempting smaller reporting companies, the final rule has certain other exemptive and cure provisions, and many aspects apply to the members of the board who oversee compensation decisions when there is no formal compensation committee.

### Compensation Consultant Disclosure and Related Conflicts of Interest

In addition, the SEC adopted an amendment to Item 407 of Regulation S-K providing that, with respect to compensation consultants retained by the compensation committee or management who must be identified in accordance with existing Item 407 and whose work has raised any conflict of interest issues, companies must disclose the nature of the conflict and how it is being addressed. In making such a determination, companies must, at a minimum, consider the factors discussed above with respect to the compensation committee's consideration of adviser independence. Unlike the proposal, the SEC decided not to eliminate the disclosure exemption for compensation consulting services involving only broad-based, non-discriminatory plans and the provision of non-customized survey data. All SEC reporting companies, whether or not listed on an Exchange, must include this new information in any proxy or information statement for annual meetings (or special meetings in lieu of annual meetings at which directors are to be elected) occurring on or after January 1, 2013.

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#### About Me

I am a former SEC attorney who also has prior "big firm" experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you. Visit my bio at [www.ober.com/attorneys/penny-somer-greif](http://www.ober.com/attorneys/penny-somer-greif).

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