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SEC Issues Final Dodd-Frank Rules on Independence of Compensation Committee and Its Advisers

The SEC yesterday promulgated final rules implementing the Dodd-Frank Act's requirements regarding the independence of compensation committee members at public companies and of their advisers. The final rules, like the proposed rules issued by the SEC last year, generally codify the Dodd-Frank statutory requirements that (1) all compensation committee members satisfy independence standards to be established by each stock exchange and (2) compensation committees have access to independent advisers and consider independence factors in selecting advisers. The rules also implement disclosure obligations relating to compensation consultant conflicts of interest.

Compensation Committee Independence. Under the final rules, compensation committee members must satisfy independence standards to be established by the securities exchanges, which are to be submitted to the SEC within 90 days of publication of the final rules. In establishing independence requirements, exchanges must consider specified factors, including the source of compensation of a director and any affiliations of the director with the issuer and its affiliates. Given that independence requirements that are generally perceived as adequate already apply to compensation committee members under tax and securities regulations, as well as under existing rules at some exchanges, we are hopeful that the exchanges will consider and incorporate these existing rules in fashioning independence standards under Dodd-Frank.

Adviser Independence. The final rules require that compensation committees have sole discretion and adequate funding to retain the services of a compensation consultant, independent legal counsel or other adviser. The rules further provide that such advisers may be retained only after consideration of certain enumerated independence-related factors, including (1) whether the adviser provides other services to the issuer, (2) fees received by the adviser's firm from the issuer, (3) conflict of interest policies of the adviser's firm, (4) any relationships between the adviser and members of the compensation committee, (5) any stock ownership by the adviser in the issuer and (6) any relationships between the adviser or the adviser's firm and an executive officer of the issuer. Importantly, the rules do not require that a compensation committee only hire independent advisers; they mandate only that these factors be considered in the selection of an adviser.

Disclosure. Existing SEC rules require various disclosures in the annual proxy statement regarding compensation consultants with a role in determining executive or director compensation. The final rules require, in proxy statements relating to annual meetings on or after January 1, 2013, additional disclosure of any conflicts of interest of any such compensation consultant, as well as a discussion of how any such conflict is being addressed.

Exemptions. Controlled companies are generally exempt from the requirements of the final rules, and the compensation committee independence rules do not apply to certain categories of issuers, including limited partnerships and companies in bankruptcy proceedings. Additionally, the exchanges may exempt certain categories of issuers from these requirements.

Companies should familiarize themselves with the final rules and should monitor the development by the applicable exchange of final independence standards under the rule.

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