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NYSE and Nasdaq Issue Proposed Listing Standard Changes Relating to
Compensation Committees to Implement the Requirements of the Dodd-Frank Act

The New York Stock Exchange and Nasdaq this week filed proposed changes to their listing standards designed to comply with the Dodd-Frank Act's requirements regarding the independence of compensation committee members and of their advisers. The proposed changes generally implement the Dodd-Frank Act's statutory requirements that (1) all compensation committee members satisfy independence standards established by each stock exchange and (2) compensation committees have access to independent advisers and consider independence factors in selecting advisers. While the proposed changes to the NYSE standards generally are limited to the implementation of the SEC rule codifying the statutory requirements, the Nasdaq proposal includes several additional requirements that more closely align the Nasdaq rules with the existing NYSE standards.

Compensation Committee Independence. In accordance with the SEC rule, the proposed listing standards require the board of directors to consider all relevant factors in determining director independence, specifically including (1) the source of compensation of a director, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and (2) whether a director is affiliated with the listed company, a subsidiary of the listed company or an affiliate of a subsidiary of the listed company. The proposed listing standards of both exchanges do not identify factors in addition to those enumerated under the SEC rule, and the NYSE proposes no additional modifications to its existing independence rules, noting that they are sufficiently broad to cover the types of relationships relevant to a director's independence. Nasdaq, however, proposes a modification to its existing independence test that would prohibit an independent director from receiving any compensation from the company other than for service as a director or fixed amounts under a retirement plan (including a deferred compensation plan) related to prior service, thereby aligning the Nasdaq compensation-related independence standards for compensation committee members with those applicable to audit committee members. Neither the NYSE nor Nasdaq, however, would impose on compensation committee members rules relating to director equity holdings of the type that apply to audit committee members. Both the NYSE and Nasdaq proposed standards provide a company with the opportunity to cure defects in the composition of the compensation committee in limited circumstances and within a specified time frame.

Role of the Compensation Committee. While NYSE companies are already required to have an independent compensation committee with a charter, the current Nasdaq standards do not impose a similar requirement and, as an alternative, permit executive compensation decisions to be made by a majority of a board's independent directors. Nasdaq's proposed standards would eliminate this alternative approach and require that compensation decisions be made by an independent compensation committee composed of at least two members. The proposed Nasdaq standards do, however, retain the existing Nasdaq exception permitting a non-independent director to serve on a compensation committee of at least three members for up to two years under exceptional and limited circumstances. The new Nasdaq standards also require the adoption of a compensation committee charter, which, among other provisions, must include the existing Nasdaq prohibition on the CEO being present during voting or deliberations on his or her compensation.

Access to Advisers and Adviser Independence. The proposed listing standards adopt the statutory and SEC requirements that compensation committees have sole discretion and adequate funding to retain the services of a compensation consultant, independent legal counsel or other adviser. While the NYSE adopted the standard in the SEC Rule, it noted that its existing standards in significant part already include these requirements. Further, the proposed listing standards incorporate the six independence-related factors enumerated in the SEC rule that compensation committees must consider before retaining an adviser, specifically (1) whether the adviser provides other services to the listed company, (2) fees received by the adviser's firm from the listed company, (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 listed company and (6) any relationships between the adviser or the adviser's firm and an executive officer of the listed company. Neither exchange identifies additional specific factors, although in accordance with the SEC rule implementing the Dodd-Frank Act, both exchanges propose listing standards that require consideration of all factors relevant to an adviser's independence. Importantly, the proposing releases emphasize that the new rules do not require that a compensation committee retain only independent advisers; they mandate only that these factors be considered in the selection of an adviser. Further, and consistent with the SEC rule, the proposed listing standards expressly provide that the adviser independence factors need not be considered with respect to advice from in-house counsel.

Exemptions. The SEC rule provides the exchanges with broad exemption authority, and the proposed listing standards of both exchanges leave their existing exemption rules generally unchanged, providing that listed companies that are currently exempt from the exchanges' compensation committee requirements (such as controlled companies) would be exempt from the enhanced requirements of the new rules. The proposed listing standards clarify that while a smaller reporting company is generally required to have a compensation committee of independent directors and a written charter, the heightened director independence factors implemented by the new standards will not apply to such companies, nor will the requirement to consider the independence of advisers.

Effectiveness. The proposed listing standards remain subject to revision based on input received during the comment process and final approval by the SEC. Pursuant to the proposing releases, compliance with the new rules generally will be required for NYSE companies by the earlier of the first annual meeting after January 15, 2014 and October 31, 2014, and for Nasdaq companies by the earlier of the second annual meeting after the changes to the listing standards are finalized and December 31, 2014. However, the Nasdaq proposing release provides that compliance with the standards relating to authority to retain independent advisers and responsibility to consider the independence of such advisers will become effective immediately upon adoption of the final listing standards. Until the adoption of the final standards, companies should familiarize themselves with the applicable exchange's proposed standards and monitor the development of amended or final listing standards.

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