

Corporate & Financial Weekly Digest

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SEC Proposes Rules Implementing Dodd-Frank Requirements Relating to Compensation Committees and Their Consultants and Advisers

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On March 30, the Securities and Exchange Commission proposed rules directing the national securities exchanges to adopt listing standards related to the compensation committees of listed companies and their consultants and advisers, as required by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added Section 10C to the Securities Exchange Act of 1934. As with all listing standards, the exchanges would need the approval of the SEC prior their adoption.

Proposed Rule 10C-1(b)(i) would direct the exchanges to adopt listing standards that would require each member of a company's compensation committee, or any other committee that oversees executive compensation, to be board members and to be independent. Proposed Rule 10C-1(b)(1)(ii) would require the exchanges to develop a definition of independence after considering relevant factors, including the source of a director's compensation, any consulting, advisory or other compensatory fee paid by the issuer to such director, and whether the director is affiliated with the issuer, one of its subsidiaries, or an affiliate of a subsidiary. Proposed Rule 10C-1(a)(3) would provide that the exchanges' listing standards may provide for a cure period if a member of a compensation committee ceases to be independent for reasons that are out of such person's control. Controlled companies, limited partnerships, companies in bankruptcy proceedings, open-ended management investment companies registered under the Investment Company Act of 1940 and any foreign private issuer that discloses in its annual report the reasons that it does not have an independent compensation committee would each be exempted from the compensation committee independence listing standards under proposed Rule 10C-1(b)(iii).

Proposed Rules 10C-1(b)(2) and 10C-1(b)(3) would direct the exchanges to adopt listing standards providing that compensation committees may obtain the advice of a compensation consultant, independent legal counsel or other adviser and shall be directly responsible for appointing, paying and overseeing their outside advisers. Listed issuers would also be required to provide funds for any such adviser. Proposed Rule 10C-1(b)(4) would require the exchanges to adopt a listing rule that provides that a compensation committee must consider the following factors when selecting a compensation adviser:

- whether the consulting company employing the compensation adviser is providing any other services to the company;
- how much the consulting company that employs the compensation adviser has received in fees from the company, expressed as a percentage of its total revenue;
- what policies and procedures have been adopted by the consulting company employing the compensation adviser to prevent conflicts of interest;
- whether the compensation adviser has any business or personal relationship with a member of the compensation committee; and
- whether the compensation adviser owns any stock of the issuer.

The proposed rules would also amend Item 407(e)(3)(iii) of Regulation S-K to require an issuer to disclose in its proxy statement whether (1) its compensation committee has retained or obtained the advice of a compensation consultant or (2) the work of a compensation consultant has raised any conflict of interest, and, if so, the nature of such conflict and how it is being addressed. The proposed amendments to Item 407(e)(3)(iii) would eliminate the current disclosure exception for services that are limited to consulting on any broad-based plans and the provision of information that is not customized for the issuer. However, the exception has been retained for purposes of fee disclosure requirements.

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