



RADFORD ALERT

NYSE Releases Proposed Listing Standards to Implement New Independence Requirements Under SEC Rule 10C-1

At the end of June 2012, the Securities and Exchange Commission (SEC) released final rules under Section 952 of the Dodd-Frank Wall Street Reform Act pertaining to Compensation Committee and compensation adviser independence. The new standards include the adoption of Rule 10C-1 under the Securities and Exchange Act of 1934 (Rule 10C-1) and amendments to Item 407 of Regulation S-K (Item 407). Together, these standards will now govern the process by which Boards maintain the independence of Compensation Committees, manage potential conflicts of interests and assess the impartiality of key advisers, namely compensation consultants.

Following the publication of its new independence standards, the SEC required all US exchanges to file proposed listing requirements addressing the implementation of Rule 10C-1 by September 25, 2012. To this end, the following Radford Alert summarizes key elements of the proposed listing requirements recently announced by the New York Stock Exchange (NYSE). To read the complete NYSE rule proposal, [click here](#).

For a refresher on the SEC's final independence standards published in June, we encourage clients to read the Radford Alert: [Assessing the Impact of New SEC Compensation Committee Independence Standards](#).

Compensation Committee Independence

With respect to Compensation Committee member independence, the NYSE generally views its existing requirements, as set forth in Section 303A.02 of its listing standards, as sufficient for assessing Director independence. However, the NYSE proposed to amend its rules slightly to comply with SEC Rule 10C-1.

Board Action Items:

The NYSE believes its existing "bright line" independence standards are sufficiently broad to encompass the types of relationships that could impact a Director's independence. And when combined with its newly proposed listing rule 303A.02(a)(ii), provides an appropriate standard for independence that is consistent with the Rule 10C-1.

Currently, NYSE rule Section 303A.02(a) "provides that no Director qualifies as 'independent' unless the Board of Directors affirmatively determines that the Director has no material relationship with the listed company (directly or as a partner, shareholder or officer of an organization that has a relationship with the company)."

In addition, Section 303A.02(b) "provides that a Director may not be deemed to be independent if such Director has a relationship with the listed company which violates any one of five 'bright line' tests." (To learn more about the NYSE's bright line independence tests, [see page 5](#) of the NYSE's recently proposed listing standards.)

According to the NYSE's proposed rules, Section 303A.02(b) will "continue to be applicable to independence determinations in relation to Compensation Committee service, as Compensation Committee members will be required to be independent under the exchange's general Board independence standards set forth in Section 303A.02, in addition to the independence requirements proposed specifically for Compensation Committee service" by the SEC.

However, to further augment its existing guidelines, the NYSE proposes to amend Section 303A.02(a) of its listing rules to adopt proposed Section 303A.02(a)(ii). This new section would require that:

In affirmatively determining the independence of any Director who will serve on the Compensation Committee of the listed company's Board of Directors, the Board of Directors must consider all factors specifically relevant to determining whether a Director has a relationship to the listed company which is material to that Director's ability to be independent from management in connection with the duties of a Compensation Committee member, including, but not limited to, the two factors explicitly enumerated [by the SEC in Rule 10C-1.]

The NYSE goes on to note, that:

When considering the sources of a Director's compensation in determining his independence for purposes of Compensation Committee service, commentary to proposed Section 303A.02(a)(ii) provides that the Board should consider whether the Director receives compensation from any person or entity that would impair his ability to make independent judgments about the listed company's executive compensation.

Similarly, when considering any affiliate relationship a Director has with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company, in determining his independence for purposes of Compensation Committee service, the proposed commentary provides that the Board should consider whether the affiliate relationship places the Director under the direct or indirect control of the listed company or its senior management, or creates a direct relationship between the Director and members of senior management, in each case of a nature that would impair his ability to make independent judgments about the listed company's executive compensation.

Overall, the NYSE believes its existing "bright line" independence standards are sufficiently broad to encompass the types of relationships that could impact a Director's independence for the purposes of serving on a Compensation Committee. And when combined with the newly proposed requirements of Section 303A.02(a)(ii), an appropriate standard for independence is created that is consistent with SEC Rule 10C-1.

Compensation Adviser Independence

According to the NYSE's proposed rule release, the exchange believes the six compensation advisor independence factors under SEC Rule 10C-1 are generally sufficient. As such, the NYSE will follow the SEC's guidance and will not require companies to consider "any specific additional factors" in its newly proposed listing requirement called Section 303A.05(c). For reference, the six factors enumerated by the SEC in June include:

1. Whether the compensation consulting company employing the compensation adviser is providing any other services to the company;
2. How much the compensation consulting company who employs the compensation adviser has received in fees from the company, as a percentage of the firm's total revenue;
3. What policies and procedures have been adopted by the compensation consulting company employing the compensation adviser to prevent conflicts of interest;
4. Whether the compensation adviser has any business or personal relationship with a member of the Compensation Committee;

Board Action Items:

Consider the adoption of a formal policy governing reviews of compensation adviser independence. Aligning policies with SEC factors (that still provide significant room for Committee discretion) could make compliance more straight forward.

5. Whether the compensation adviser owns any stock of the company; and
6. Whether the compensation adviser or the person employing the adviser has any business or personal relationship with an executive officer of the issuer.

However, the NYSE's proposed listing standards would also require the Compensation Committee to "consider any other factors that would be relevant to the adviser's independence from management." Again, these "other factors" are not specifically enumerated by the NYSE, leaving Compensation Committees with sufficient discretion in this area.

Furthermore, the NYSE proposes to include in Section 303A.05(c) an explicit statement that nothing in Section 303A.05(c) shall be construed:

- > to require the Compensation Committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel or other adviser to the Compensation Committee; or
- > to affect the ability or obligation of the Compensation Committee to exercise its own judgment in fulfillment of the duties of the Compensation Committee (or, if applicable, the independent Directors).

These statements explicitly reaffirm the ability of Compensation Committees to use significant discretion when selecting compensation advisors, which the SEC also affirmed when it originally published Rule 10C-1. Finally, Section 303A.05(c)iv of the NYSE's proposed listing requirements also requires Compensation Committees to conduct independence assessments with respect to any compensation consultant, legal counsel or other adviser that provides advice to the Compensation Committee, other than in-house legal counsel. This is a point Boards of NYSE-listed companies should not overlook when considering the adopting of or amendments to advisor independence policies.

Timing of New Requirements

As currently proposed, the NYSE's updated listing requirements covering Compensation Committee member independence will require companies to comply by the earlier of their first annual meeting after January 15, 2014, or October 31, 2014. New listing requirements related compensation adviser access and compensation adviser independence will become effective July 1, 2013. Existing transition rules for recently public companies continue to apply.

Next Steps

The SEC's release of final independence standards under Section 952 of the Dodd-Frank Wall Street Reform Act brings to a close just one of the many highly anticipated compensation-related rulemaking efforts under the landmark piece of legislation. However, several outstanding issues remain, which Boards must continue to monitor in the coming months. These include final rules on clawback policies, pay-for-performance disclosures, and CEO-to-worker pay ratios, among other items.

In the near-term, now that each US exchange has released proposed listing requirements under the SEC's new independence standards, Boards must continue to monitor the SEC and relevant exchanges for the publication of final listing requirements – which are due no later than June 27, 2013. Next, Boards must define their own internal policies for assessing the independence of Compensation Committee members, followed by decisions on the extent to which they should formalize independence policies for compensation advisors.

Again, for a refresher on the SEC's final independence standards published in June, we encourage clients to read our client alert: [Assessing the Impact of New SEC Compensation Committee Independence Standards](#).

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