Chapter 4A

Compensation Committee
Responsibilities and Authority

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§ 4A:1 Overview

This chapter 4A describes the rules of the SEC, the NYSE and Nasdaq relating to compensation committee responsibilities and authority. Section 952 of the Dodd-Frank Act added a new section 10C to the Exchange Act, pursuant to which the SEC promulgated rules requiring national securities exchanges to prohibit the listing of an issuer’s equity securities if its board does not have an independent compensation committee, and to require issuers to expand their compensation committee’s authority and responsibilities with respect to compensation advisers. The implementing stock exchange rules were approved in January 2013 and went into effect in July 2013.

Requirements relating to compensation committee composition are discussed in chapter 4B and related SEC disclosure requirements are discussed in chapter 4C.

§ 4A:2 Text of Rules Regarding Compensation Committee Responsibilities and Authority

We have set out below the text of the SEC, NYSE and Nasdaq relating to compensation committee responsibilities and authority.

§ 4A:2.1 Text of NYSE Rules Relating to Compensation Committee Responsibilities

The following sets out the relevant text of sections 303A.00 and 303A.05 of the NYSE Listed Company Manual, including the accompanying official commentary, which should be considered part of the rules.

303A.05 COMPENSATION COMMITTEE

(a) Listed companies must have a compensation committee composed entirely of independent directors. Compensation committee members must satisfy the additional independence requirements specific to compensation committee membership set forth in Section 303A.02(a)(ii).

(b) The compensation committee must have a written charter that addresses:

(i) the committee’s purpose and responsibilities—which, at minimum, must be to have direct responsibility to:

(A) review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO’s performance in light of those goals and objectives, and, either as a committee or together with the other independent directors (as directed by the
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board), determine and approve the CEO’s compensation level based on this evaluation;

(B) make recommendations to the board with respect to non-CEO executive officer compensation, and incentive-compensation and equity-based plans that are subject to board approval; and

(C) prepare the disclosure required by Item 407(e)(5) of Regulation S-K;

(ii) an annual performance evaluation of the compensation committee;

(iii) the rights and responsibilities of the compensation committee set forth in Section 303A.05(c).

Commentary: In determining the long-term incentive component of CEO compensation, the committee should consider the listed company’s performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, and the awards given to the listed company’s CEO in past years. To avoid confusion, note that the compensation committee is not precluded from approving awards (with or without ratification of the board) as may be required to comply with applicable tax laws (i.e., Rule 162(m)). Note also that nothing in Section 303A.05(b)(i)(B) is intended to preclude the board from delegating its authority over such matters to the compensation committee.

The compensation committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board.

Boards may allocate the responsibilities of the compensation committee to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a committee charter.

Nothing in this provision should be construed as precluding discussion of CEO compensation with the board generally, as it is not the intent of this standard to impair communication among members of the board.

Website Posting Requirement: A listed company must make its compensation committee charter available on or through its website. If any function of the compensation committee has been delegated to
another committee, the charter of that committee must also be made available on or through the listed company’s website.

Disclosure Requirements: A listed company must disclose in its annual proxy statement or, if it does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC that its compensation committee charter is available on or through its website and provide the website address.

(c)(i) The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser.

(ii) The compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel or other adviser retained by the compensation committee.

(iii) The listed company must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to a compensation consultant, independent legal counsel or any other adviser retained by the compensation committee.

(iv) The compensation committee may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration, all factors relevant to that person’s independence from management, including the following:

(A) The provision of other services to the listed company by the person that employs the compensation consultant, legal counsel or other adviser;

(B) The amount of fees received from the listed company by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;

(C) The policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;

(D) Any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee.
Commentary: Nothing in this Section 303A.05(c) shall be construed: (A) 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 (B) to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

The compensation committee is required to conduct the independence assessment outlined in Section 303A.05(c)(iv) with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than (i) in-house legal counsel; and (ii) any compensation consultant, legal counsel or other adviser whose role is limited to the following activities for which no disclosure would be required under Item 407(e)(3)(iii) of Regulation S-K: consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the listed company, and that is available generally to all salaried employees; or providing information that either is not customized for a particular company or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide.

Nothing in this Section 303A.05(c) requires a compensation consultant, legal counsel or other compensation adviser to be independent, only that the compensation committee consider the enumerated independence factors before selecting or receiving advice from a compensation adviser. The compensation committee may select or receive advice from any compensation adviser they prefer including ones that are not independent, after considering the six independence factors outlined in Section 303A.05(c)(iv)(A)–(F).

§ 4A:2.2 Text of Nasdaq Rules Relating to Compensation Committee Responsibilities

The following sets out the relevant text of Nasdaq Rules 5605(d)(1), (3), (5) and (6), including the accompanying official interpretations, which should be considered part of the rules.

Rule 5605. Board of Directors and Committees
(d) Compensation Committee Requirements

The provisions of this Rule 5605(d) and IM-5605-6 are operative only subject to the effective dates outlined in Rule 5605(d)(6). During the transition period until a Company is required to comply with a particular provision, the Company must continue to comply with the corresponding provision, if any, of Rule 5605A(d) and IM-5605A-6.
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(1) Compensation Committee Charter

Each Company must certify that it has adopted a formal written compensation committee charter and that the compensation committee will review and reassess the adequacy of the formal written charter on an annual basis. The charter must specify:

(A) the scope of the compensation committee’s responsibilities, and how it carries out those responsibilities, including structure, processes and membership requirements;

(B) the compensation committee’s responsibility for determining, or recommending to the board for determination, the compensation of the chief executive officer and all other Executive Officers of the Company;

(C) that the chief executive officer may not be present during voting or deliberations on his or her compensation; and

(D) the specific compensation committee responsibilities and authority set forth in Rule 5605(d)(3).

[The text of Rule 5605(d)(2), relating to compensation committee composition, and the related interpretation are set forth in chapter 4B.]

(3) Compensation Committee Responsibilities and Authority

As required by Rule 10C-1(b)(2), (3) and (4)(i)–(vi) under the Act, the compensation committee must have the following specific responsibilities and authority.

(A) The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation consultant, legal counsel or other adviser.

(B) The compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, legal counsel and other adviser retained by the compensation committee.

(C) The Company must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to a compensation consultant, legal counsel or any other adviser retained by the compensation committee.

(D) The compensation committee may select, or receive advice from, a compensation consultant, legal counsel or other advis-
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er to the compensation committee, other than in-house legal counsel, only after taking into consideration the following factors:

(i) the provision of other services to the Company by the person that employs the compensation consultant, legal counsel or other adviser;

(ii) the amount of fees received from the Company by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;

(iii) the policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;

(iv) any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee;

(v) any stock of the Company owned by the compensation consultant, legal counsel or other adviser; and

(vi) any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an Executive Officer of the Company.

Nothing in this Rule shall be construed: (i) to require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, legal counsel or other adviser to the compensation committee; or (ii) to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

The compensation committee is required to conduct the independence assessment outlined in this Rule with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel. However, nothing in this Rule requires a compensation consultant, legal counsel or other compensation adviser to be independent, only that the compensation committee consider the enumerated independence factors before selecting, or receiving advice from, a compensation adviser. Compensation committees may select, or receive advice from,
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any compensation adviser they prefer, including ones that are not independent, after considering the six independence factors outlined above.

For purposes of this Rule, the compensation committee is not required to conduct an independence assessment for a compensation adviser that acts in a role limited to the following activities for which no disclosure is required under Item 407(e)(3)(iii) of Regulation S-K: (a) consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of Executive Officers or directors of the Company, and that is available generally to all salaried employees; and/or (b) providing information that either is not customized for a particular issuer or that is customized based on parameters that are not developed by the adviser, and about which the adviser does not provide advice.

[The text of Rule 5605(d)(4), relating to cure periods for the compensation committee composition requirements, is set forth in chapter 4B.]

(5) Smaller Reporting Companies

A Smaller Reporting Company, as defined in Rule 12b-2 under the Act, is not subject to the requirements of Rule 5605(d), except that a Smaller Reporting Company must have, and certify that it has and will continue to have, a compensation committee of at least two members, each of whom must be an Independent Director as defined under Rule 5605(a)(2). A Smaller Reporting Company may rely on the exception in Rule 5605(d)(2)(B) and the cure period in Rule 5605(d)(4). In addition, a Smaller Reporting Company must certify that it has adopted a formal written compensation committee charter or board resolution that specifies the content set forth in Rule 5605(d)(1)(A)–(C). A Smaller Reporting Company does not need to include in its formal written compensation committee charter or board resolution the specific compensation committee responsibilities and authority set forth in Rule 5605(d)(3).

(6) Effective Dates of Rule 5605(d) and IM-5605-6; Transition for Companies Listed on Nasdaq as of the Effective Dates

The provisions of Rule 5605(d)(3) shall be effective on July 1, 2013; to the extent a Company does not have a compensation committee in the period before the final implementation deadline applicable to it as outlined in the paragraph below, the provisions of Rule 5605(d)(3) shall apply to the Independent Directors who
determine, or recommend to the board for determination, the compensation of the chief executive officer and all other Executive Officers of the Company. Companies should consider under state corporate law whether to grant the specific responsibilities and authority referenced in Rule 5605(d)(3) through a charter, resolution or other board action; however, Nasdaq requires only that a compensation committee, or Independent Directors acting in lieu of a compensation committee, have the responsibilities and authority referenced in Rule 5605(d)(3) on July 1, 2013. Companies must have a written compensation committee charter that includes, among others, the responsibilities and authority referenced in Rule 5605(d)(3) by the implementation deadline set forth in the paragraph below.

In order to allow Companies to make necessary adjustments in the course of their regular annual meeting schedule, Companies will have until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, to comply with the remaining provisions of Rule 5605(d) and IM-5605-6. A Company must certify to Nasdaq, no later than 30 days after the final implementation deadline applicable to it, that it has complied with Rule 5605(d).

During the transition period, Companies that are not yet required to comply with a particular provision of revised Rule 5605(d) and IM-5605-6 must continue to comply with the corresponding provision, if any, of Rule 5605A(d) and IM-5605A-6.

IM-5605-6. Independent Director Oversight of Executive Compensation

[...]

A Smaller Reporting Company must have a compensation committee with a minimum of two members. Each compensation committee member must be an Independent Director as defined under Rule 5605(a)(2). In addition, each Smaller Reporting Company must have a formal written compensation committee charter or board resolution that specifies the committee's responsibilities and authority set forth in Rule 5605(d)(1)(A)–(C). However, in recognition of the fact that Smaller Reporting Companies may have fewer resources than larger Companies, Smaller Reporting Companies are not required to adhere to the additional compensation committee eligibility requirements in Rule 5605(d)(2)(A), or to incorporate into their formal written compensation committee charter or board resolution the specific compensation committee responsibilities and authority set forth in Rule 5605(d)(3).
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Text of Rule 10C-1 Under the Exchange Act

Rule 10C-1. Listing standards relating to compensation committees.


(1) National securities exchanges. The rules of each national securities exchange registered pursuant to section 6 of the Act (15 U.S.C. 78f), to the extent such national securities exchange lists equity securities, must, in accordance with the provisions of this section, prohibit the initial or continued listing of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(2) National securities associations. The rules of each national securities association registered pursuant to section 15A of the Act (15 U.S.C. 78o-3), to the extent such national securities association lists equity securities in an automated inter-dealer quotation system, must, in accordance with the provisions of this section, prohibit the initial or continued listing in an automated inter-dealer quotation system of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(3) Opportunity to cure defects. The rules required by paragraphs (a)(1) and (a)(2) of this section must provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for a prohibition under paragraph (a) of this section, before the imposition of such prohibition. Such rules may provide that if a member of a compensation committee ceases to be independent in accordance with the requirements of this section for reasons outside the member’s reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain a compensation committee member of the listed issuer until the earlier of the next annual shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

(4) Implementation.

(i) Each national securities exchange and national securities association that lists equity securities must provide to the Commission, no later than 90 days after publication of this section in the Federal Register, proposed rules or rule amendments that comply with this section. Each submission must include, in ad-
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dition to any other information required under section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, a review of whether and how existing or proposed listing standards satisfy the requirements of this rule, a discussion of the consideration of factors relevant to compensation committee independence conducted by the national securities exchange or national securities association, and the definition of independence applicable to compensation committee members that the national securities exchange or national securities association proposes to adopt or retain in light of such review.

(ii) Each national securities exchange and national securities association that lists equity securities must have rules or rule amendments that comply with this section approved by the Commission no later than one year after publication of this section in the Federal Register.

(b) Required standards. The requirements of this section apply to the compensation committees of listed issuers.

[The text of Rule 10C-1[b][1] relating to compensation committee independence is set forth in section 4B:2.3.]

(2) Authority to retain compensation consultants, independent legal counsel and other compensation advisers.

(i) The compensation committee of a listed issuer, in its capacity as a committee of the board of directors, may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser.

(ii) The compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel and other adviser retained by the compensation committee.

(iii) Nothing in this paragraph (b)(2) shall be construed:

(A) 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

(B) to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

(3) Funding. Each listed issuer must provide for appropriate funding, as determined by the compensation committee, in its capacity
as a committee of the board of directors, for payment of reasonable compensation to a compensation consultant, independent legal counsel or any other adviser retained by the compensation committee.

(4) Independence of compensation consultants and other advisers. The compensation committee of a listed issuer may select a compensation consultant, legal counsel, or other adviser to the compensation committee only after taking into consideration the following factors, as well as any other factors identified by the relevant national securities exchange or national securities association in its listing standards:

(i) the provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;

(ii) the amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel, or other adviser;

(iii) the policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;

(iv) any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee;

(v) any stock of the issuer owned by the compensation consultant, legal counsel or other adviser; and

(vi) any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an Executive Officer of the issuer.

Instruction to paragraph (b)(4) of this section: A listed issuer’s compensation committee is required to conduct the independence assessment outlined in paragraph (b)(4) of this section with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

(5) General exemptions.

(i) The national securities exchanges and national securities associations, pursuant to section 19(b) of the Act (15 U.S.C.
78s(b)) and the rules thereunder, may exempt from the requirements of this section certain categories of issuers, as the national securities exchange or national securities association determines is appropriate, taking into consideration, among other relevant factors, the potential impact of such requirements on smaller reporting issuers.

(ii) The requirements of this section shall not apply to any controlled company or to any smaller reporting company.

(iii) The listing of a security futures product cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q-1(b)(7)(A)) is not subject to the requirements of this section.

(iv) The listing of a standardized option, as defined in § 240.9b-1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) is not subject to the requirements of this section.

(c) Definitions. Unless the context otherwise requires, all terms used in this section have the same meaning as in the Act and the rules and regulations thereunder. In addition, unless the context otherwise requires, the following definitions apply for purposes of this section:

1. In the case of foreign private issuers with a two-tier board system, the term board of directors means the supervisory or non-management board.

2. The term compensation committee means:

   (i) a committee of the board of directors that is designated as the compensation committee; or

   (ii) in the absence of a committee of the board of directors that is designated as the compensation committee, a committee of the board of directors performing functions typically performed by a compensation committee, including oversight of executive compensation, even if it is not designated as the compensation committee or also performs other functions; or

   (iii) for purposes of this section other than paragraphs (b)(2)(i) and (b)(3), in the absence of a committee as described in paragraphs (c)(2)(i) or (ii) of this section, the members of the board of directors who oversee executive compensation matters on behalf of the board of directors.
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The term **controlled company** means an issuer:

(i) that is listed on a national securities exchange or by a national securities association; and

(ii) of which more than 50 percent of the voting power for the election of directors is held by an individual, a group or another company.

The terms **listed** and **listing** refer to equity securities listed on a national securities exchange or listed in an automated inter-dealer quotation system of a national securities association or to issuers of such securities.

The term **open-end management investment company** means an open-end company, as defined by Section 5(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-5(a)(1)), that is registered under that Act.

§ 4A:3  **Sample Compensation Committee Charter for Listed U.S. Companies**

The following are annotated sample forms of compensation committee charters that U.S. companies listed on the NYSE or Nasdaq can use as a starting point to create or modify their own.

**§ 4A:3.1 NYSE-Listed U.S. Companies**

NYSE-listed U.S. companies can use this sample charter as a starting point to create or modify their own. The annotations indicate the NYSE rule or other legal requirement upon which the relevant provision is based. The underlying form of compensation committee charter is for illustrative purposes only and should be tailored to fit the particular circumstances of each company. The language underscored has been added in light of the listing standards amendments adopted in 2013.

**Committee Membership**

The Compensation Committee (the “Committee”) of the Board of Directors (the “Board”) of [Name of Corporation] (the “Company”) shall consist solely of three or more members of the Board, each of whom the Board has determined has no material relationship with the Company and each of whom is otherwise “independent” under the rules of the New York Stock Exchange, Inc. as they apply to compensation committee members. [NYSE 303A.02 and .05(a)]
Members shall be appointed by the Board [based on nominations recommended by the Company's Nominating Committee]. Members shall serve at the pleasure of the Board and for such term or terms as the Board may determine. [Discuss qualifications for committee members.] [NYSE 303A.05 (commentary recommends, but does not require, that charter address committee member qualifications, appointment and removal)]

Committee Purpose and Responsibilities

The Committee shall have the purpose and direct responsibility to:

1. Review and approve corporate goals and objectives relevant to the compensation of the Company’s Chief Executive Officer (“CEO”), evaluate the CEO’s performance in light of those goals and objectives, and either as a committee or together with the other independent directors (as directed by the Board), determine and approve the CEO’s compensation level based on this evaluation [NYSE 303A.05(b)(i)(A)]. In determining the long-term incentive component of CEO compensation, the Committee shall consider, among other factors, the Company’s performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, the awards given to the CEO in past years, and [list other factors, if any]. [NYSE 303A.05 (commentary recommends, but does not require, that the committee consider these factors)]

2. [Make recommendations to] [Discharge the responsibilities of] the Board with respect to non-CEO executive officer compensation, incentive-compensation plans and equity-based plans that are subject to board approval [, including [list specific plans currently in existence], oversee the activities of the individuals and committees responsible for administering these plans, including [list specific committees to be overseen], and discharge any responsibilities imposed on the Committee by any of these plans]. [NYSE 303A.05(b)(i)(B)]

3. Approve any new equity compensation plan or any material change to an existing plan where shareholder approval has not been obtained. [NYSE 303A.08 (commentary)]

4. In consultation with management, oversee regulatory compliance with respect to compensation matters, including overseeing the Company’s policies on structuring compensation programs to preserve tax deductibility, and, as and when required, establishing performance goals and certifying that
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performance goals have been attained for purposes of Section 162(m) of the Internal Revenue Code. [NYSE 303A.05 (commentary notes committee may approve awards pursuant to 162(m))]

5. [Make recommendations to the Board with respect to any severance or similar termination payments proposed to be made to any current or former [executive officer] [member of senior management] of the Company.]

6. Prepare an annual Compensation Committee Report for inclusion in the Company’s annual proxy statement in accordance with applicable SEC rules and regulations. [NYSE 303A.05(b)(i)(C) and Item 407(e)(5) (Compensation Committee Report) of Regulation S-K]

7. Prepare and issue the evaluation required under “Performance Evaluation” below. [NYSE 303A.05(b)(i)(C) and (ii)]

8. Report to the Board on a regular basis, and not less than once per year. [NYSE 303A.05 (commentary recommends, but does not require, that charter address committee reporting to the Board)]

9. Perform any other duties or responsibilities expressly delegated to the Committee by the Board from time to time relating to the Company’s compensation programs.

Committee Structure and Operations

The [Board] [Committee] shall designate one member of the Committee as its chairperson. [In the event of a tie vote on any issue, the chairperson’s vote shall decide the issue.] The Committee shall meet at least [three times] a year at a time and place determined by the Committee chairperson, with further meetings to occur, or actions to be taken by unanimous written consent, when deemed necessary or desirable by the Committee or its chairperson. Members of the Committee may participate in a meeting of the Committee by means of conference call or similar communications equipment by means of which all persons participating in the meeting can hear each other. [NYSE 303A.05 (commentary recommends, but does not require, that charter address committee structure and operations)]

[The Committee may invite such members of management to its meetings as it deems appropriate, consistent with the maintenance of the confidentiality of compensation discussions. The CEO should not attend any meeting where the CEO’s performance or compensation is]
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discussed, unless specifically invited by the Committee. [NYSE 303A.05 (commentary recommends, but does not require, that charter address committee structure and operations)]

Delegation to Subcommittee

The Committee may, in its discretion, delegate all or a portion of its duties and responsibilities to a subcommittee of the Committee. In particular, the Committee may delegate the approval of certain transactions to a subcommittee consisting solely of members of the Committee who are (i) “Non-Employee Directors” for the purposes of Rule 16b-3 under the Securities Exchange Act of 1934, as in effect from time to time, and (ii) “outside directors” for the purposes of Section 162(m) of the Internal Revenue Code, as in effect from time to time. [NYSE 303A.05 (commentary recommends, but does not require, that charter address delegation to subcommittees)]

Performance Evaluation

The Committee shall prepare and review with the Board an annual performance evaluation of the Committee, which evaluation shall compare the performance of the Committee with the requirements of this charter. The performance evaluation shall also recommend to the Board any improvements to the Committee’s charter deemed necessary or desirable by the Committee. The performance evaluation by the Committee shall be conducted in such manner as the Committee deems appropriate. The report to the Board may take the form of an oral report by the chairperson of the Committee or any other member of the Committee designated by the Committee to make this report. [NYSE 303A.05(b)(ii)]

Resources and Authority of the Committee

The Committee shall have the resources, funding and authority appropriate to discharge its duties and responsibilities, including the authority to select, retain, terminate and approve the fees and other retention terms of any compensation consultants, outside legal counsel or other advisers to the Committee (each, an “Adviser”), as it deems appropriate, without seeking approval of the Board or management. The Committee shall be directly responsible for the appointment, compensation and oversight of the work of any Adviser it retains. [To the extent required by NYSE rules, the] [The] Committee may select

1. Insertion of this bracketed phrase is intended to allow the Committee to determine not to conduct an independence assessment in the case of an Adviser whose role is limited to: consulting on any broad-based plan that
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or receive advice from an Adviser only after taking into consideration all factors relevant to the Adviser’s independence from management, including the following:

- the provision of other services to the Company by the person that employs the Adviser;
- the amount of fees received from the Company by the person that employs the Adviser as a percentage of that person’s total revenue;
- the policies and procedures of the person that employs the Adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the Adviser with a member of the Committee;
- any stock of the Company owned by the Adviser; and
- any business or personal relationship of the Adviser or the person employing the Adviser with an executive officer of the Company.

Although the Committee is required to consider these factors, it is free to select or receive advice from an Adviser that is not independent. [NYSE 303A.05(c)]

§ 4A:3.2 Nasdaq-Listed U.S. Companies

Nasdaq-listed U.S. companies can use this sample charter as a starting point to create or modify their own. The annotations indicate the Nasdaq rule or other legal requirement upon which the relevant provision is based. The underlying form of compensation committee charter is for illustrative purposes only and should be tailored to fit the particular circumstances of each company. The language underscored has been added in light of the listing standards amendments adopted in 2013.

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1. Does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the listed company, and that is available generally to all salaried employees, or providing information that either is not customized for the Company or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice. NYSE rules do not require an independence assessment in these circumstances.

2. Instead of listing out the factors, some companies may determine only to reference them, which could be done by replacing the words “including the following” with “including the factors set forth in the NYSE rules.”
Committee Membership

Except as [provided below,] [permitted by Nasdaq Rule 5605(d),] the Compensation Committee (the “Committee”) of the Board of Directors (the “Board”) of [Name of Corporation] (the “Company”) shall consist solely of “independent directors,” i.e., those directors who neither are officers or employees of the Company or its subsidiaries nor have a relationship which, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director, and who are otherwise “independent” under the rules of the Nasdaq Stock Market, Inc. as they apply to compensation committee members. [Nasdaq 5605(d)(2)]

Members shall be appointed by the Board [based on nominations by the Company’s [Corporate Governance and] Nominations Committee] [Nasdaq 5605(e)(1)]. Members shall serve at the pleasure of the Board and for such term or terms as the Board may determine. [Discuss qualifications for committee members.]

[If the Committee is comprised of at least three members, one director who is not independent and is not a current officer or employee, or a spouse, parent, child or sibling, whether by blood, marriage or adoption, of, or a person who has the same residence as, any current officer or employee, may be appointed to the Committee if the Board, under exceptional and limited circumstances, determines that such individual’s membership on the Committee is required by the best interests of the Company and its stockholders, and the Board discloses, in the next annual meeting proxy statement [(or [Form 10-K] [Form 20-F] if no proxy statement is filed)] or on its website subsequent to such determination, the nature of the relationship between the director and the Company, and the reasons for the determination. Any such member appointed to the Committee may only serve for up to two years. [Nasdaq 5605(d)(2)(B)] [May be included if applicable.]

Committee Purpose and Responsibilities

The Committee shall have the purpose and direct responsibility to:

1. Review and approve corporate goals and objectives relevant to the compensation of the Company’s Chief Executive Officer (“CEO”), evaluate the CEO’s performance in light of those goals and objectives, and either as a committee or together with the other independent directors (as directed by the Board), determine, or recommend to the Board for determination, the CEO’s compensation level based on this evaluation [Nasdaq 5605(d)(1)]. In determining or recommending the long-term incentive component of CEO compensation, the
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The Committee shall consider, among other factors, the Company’s performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, the awards given to the CEO in past years, and [list other factors, if any].

2. Either as a committee or together with the other independent directors (as directed by the Board), determine, or recommend to the Board for determination, the compensation of all other executive officers of the Company. [Nasdaq 5605(d)(1)]

3. [Make recommendations to] [Discharge the responsibilities of] the Board with respect to the Company’s incentive compensation plans and equity-based plans [, including [list specific plans currently in existence], oversee the activities of the individuals and committees responsible for administering these plans, including [list specific committees to be overseen], and discharge any responsibilities imposed on the Committee by any of these plans.]

4. [Approve issuances under, or any material amendment of, any tax qualified, non-discriminatory employee benefit plan or parallel nonqualified plan pursuant to which a director, officer, employee or consultant will acquire stock or options.] [Nasdaq 5635(c)(2)]

5. [Approve issuances under, or any material amendment of, any stock option or other similar plan pursuant to which a person not previously an employee or director of the Company, as an inducement material to the individual’s entering into employment with the Company, will acquire stock or options.] [Nasdaq 5635(c)(4)]

6. In consultation with management, oversee regulatory compliance with respect to compensation matters, including overseeing the Company’s policies on structuring compensation programs to preserve tax deductibility, and, as and when required, establishing performance goals and certifying that performance goals have been attained for purposes of Section 162(m) of the Internal Revenue Code.

7. Review and approve any severance or similar termination payments proposed to be made to any current or former executive officer of the Company.

8. Prepare an annual Compensation Committee Report for inclusion in the Company’s annual proxy statement in accordance
Compensation Committee Responsibilities and Authority § 4A:3.2

with applicable SEC rules and regulations. [Item 407(e)(5) (Compensation Committee Report) of Regulation S-K]

9. [Prepare and issue the evaluation required under “Performance Evaluation” below.]

10. [Report to the Board on a regular basis, and not less than once per year.]

11. Perform any other duties or responsibilities expressly delegated to the Committee by the Board from time to time relating to the Company’s compensation programs.

Committee Structure and Operations

The [Board] [Committee] shall designate one member of the Committee as its chairperson. [In the event of a tie vote on any issue, the chairperson’s vote shall decide the issue.] The Committee shall meet at least [twice] a year, and perhaps more frequently, in conjunction with regularly scheduled meetings of the Board at regularly scheduled times and places determined by the Committee chairperson, with further meetings to occur, or actions to be taken by unanimous written consent, when deemed necessary or desirable by the Committee or its chairperson [Nasdaq IM-5605-1 provides that Nasdaq contemplates that executive sessions of the independent directors will occur at least twice a year, and perhaps more frequently, in conjunction with regularly scheduled board meetings]. Members of the Committee may participate in a meeting of the Committee by means of conference call or similar communications equipment by means of which all persons participating in the meeting can hear each other.

The CEO may not be present during any voting or deliberations of the Committee regarding the CEO’s compensation. [Nasdaq 5605(d)(1)]

Delegation to Subcommittee

The Committee may, in its discretion, delegate all or a portion of its duties and responsibilities to a subcommittee of the Committee consisting of one or more members. In particular, the Committee may delegate the approval of certain transactions to a subcommittee consisting solely of members of the Committee who are (i) “Non-Employee Directors” for the purposes of Rule 16b-3 under the Securities Exchange Act of 1934, as in effect from time to time, and (ii) “outside directors” for the purposes of Section 162(m) of the Internal Revenue Code, as in effect from time to time.
§ 4A:3.2

Performance Evaluation

The Committee shall prepare and review with the Board an annual performance evaluation of the Committee, which evaluation shall compare the performance of the Committee with the requirements of this charter. The performance evaluation shall also recommend to the Board any improvements to the Committee’s charter deemed necessary or desirable by the Committee. The performance evaluation by the Committee shall be conducted in such manner as the Committee deems appropriate. The report to the Board may take the form of an oral report by the chairperson of the Committee or any other member of the Committee designated by the Committee to make this report. [Nasdaq 5605(d)(1) requires annual review of charter]

Resources and Authority of the Committee

The Committee shall have the resources, funding and authority appropriate to discharge its duties and responsibilities, including the authority to select, retain, terminate and approve the fees and other retention terms of any compensation consultants, outside legal counsel or other advisors to the Committee (each, an “Advisor”), as it deems appropriate, without seeking approval of the Board or management. The Committee shall be directly responsible for the appointment, compensation and oversight of the work of any Advisor it retains. [To the extent required by Nasdaq rules, the] The Committee may select or receive advice from an Advisor only after taking into consideration the following factors:

- the provision of other services to the Company by the person that employs the Advisor;

3. Insertion of this bracketed phrase is intended to allow the Committee to determine not to conduct an independence assessment in the case of an Advisor whose role is limited to: consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the listed company, and that is available generally to all salaried employees; or providing information that either is not customized for the listed company or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice. Nasdaq rules do not require an independence assessment in these circumstances.

4. Instead of listing out the factors, some companies may determine only to reference them, which could be done by replacing the words “the following factors” with “the factors set forth in Nasdaq rules.”

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- the amount of fees received from the Company by the person that employs the Advisor as a percentage of that person's total revenue;
- the policies and procedures of the person that employs the Advisor that are designed to prevent conflicts of interest;
- any business or personal relationship of the Advisor with a member of the Committee;
- any business or personal relationship of the Advisor or the person employing the Advisor with an executive officer of the Company; and
- any stock of the Company owned by the Advisor.

Although the Committee is required to consider these factors, it is free to select or receive advice from an Advisor that is not independent. [Nasdaq 5605(d)(1) and (3)]

§ 4A:4  NYSE Rules Relating to Compensation Committee Responsibilities

The text of the NYSE rules relating to compensation committee responsibilities and authority is set forth in section 4A:2.1. The NYSE rules, which were initially adopted in 2003 as part of the NYSE’s enhanced corporate governance listing standards, require each listed company to establish a compensation committee.  

§ 4A:4.1 Entities Subject to the Rules

The NYSE rules relating to compensation committee responsibility and authority generally apply to all U.S. companies with common stock listed on the NYSE. They, however, do not apply to:

- Controlled companies
- Limited partnerships
- Companies in bankruptcy proceedings
- SEC-registered management investment companies
- Passive business organizations in the form of trusts (such as royalty trusts)
- Entities listing only derivatives or special purpose securities

Although “smaller reporting companies” are not subject to the enhanced director independence requirements applicable to compensation committee members that took effect in 2014, they are subject to the NYSE rules relating to compensation committee responsibility and authority (other than the requirement to consider enumerated independence factors before engaging an adviser).

See section 1A:3 for additional details regarding entities subject to the NYSE corporate governance rules.

§ 4A:4.2 Timing of Effectiveness and Phase-Ins

Companies subject to the NYSE rules relating to compensation committee responsibility and authority are generally required to comply at the time of listing. Although a grace period is provided with respect to the independent member requirements, it does not apply to the other aspects of the NYSE’s rules relating to compensation committees.

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§ 4A:4.3 Application to Non-U.S. Issuers

The NYSE rules relating to compensation committee responsibility and authority do not apply to “foreign private issuers,” to the extent not otherwise required by home country law or listing rules. Representatives of the NYSE have informally confirmed that the non-U.S. issuer exemption is automatic and does not require any action on the part of a non-U.S. issuer.

§ 4A:4.4 Charter and Responsibilities

The compensation committee must have a written charter, which must be posted on the company’s website, addressing (at a minimum) the committee’s purpose and responsibilities, which must be to have direct responsibility for:

- reviewing and approving the corporate goals and objectives relevant to CEO compensation, evaluating the CEO’s performance in light of those goals and objectives and, either as a committee or together with the other independent directors (as directed by the board), determining and approving the compensation of the CEO based on this evaluation;
- making recommendations to the board (or discharging the board’s responsibilities) with respect to non-CEO executive officer compensation, incentive-compensation and equity-based plans that are subject to board approval;
- producing the annual report on executive compensation; and
- performing an annual performance evaluation of the committee.9

The rules recommend (but do not require) that the charter also address:

- committee member qualification, appointment and removal;
- committee structure and operations;
- committee reporting to the board; and
- the sole authority of the committee to retain, terminate and approve the fees and retention terms of any compensation consultant.

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7. The NYSE rules define the term “foreign private issuer” by reference to Rule 3b-4(c) under the Exchange Act.
8. See the “General Application” section of section 303A of the NYSE Listed Company Manual, which is set forth in section 1A:2.1.
9. See section 1C:6 for a discussion of a possible approach for conducting this self-evaluation.
§ 4A:4.5 Compensation Committee Advisers

In addition, the NYSE rule changes approved in January 2013 require that the committee charter must provide that the committee has broad authority and appropriate funding, as determined by the committee, to engage compensation consultants, outside legal counsel and other compensation advisers. Committees are required to consider the six independence factors enumerated in Rule 10C-1(b)(4) before selecting or receiving advice from an adviser, unless the adviser is in-house counsel or is only providing services limited to:

- consulting on any broad-based, non-discriminatory plan that is generally available to all salaried employees, or
- providing information that is either not customized for the listed company or is customized based on parameters that are not developed by the adviser and about which the adviser does not provide advice.

The independence factors set forth in section 10C of the Exchange Act, and duplicated in Rule 10C-1(b)(4) and the implementing stock exchange rules, are:

- the provision of other services to the listed company by the consultant or other adviser;
- the amount of fees received from the listed company by consultant or other adviser, as a percentage of the total revenue of the consultant or other adviser;
- the policies and procedures of the consultant or other adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the consultant or other adviser with a member of the compensation committee; and
- any stock of the listed company owned by the consultant or other adviser.

In its final rules, the SEC introduced a sixth independence factor:

- any business or personal relationship between the executive officers of the issuer and the compensation adviser or the person employing the adviser.

Although it is reasonably clear that where a compensation committee seeks to directly engage a compensation consultant, legal counsel, or other adviser, that the subject adviser should expect that, during the course of its engagement, it will provide advice to the compensation committee, it is less clear, particularly in the case
of legal counsel that has been engaged by the listed issuer itself, when its work for the issuer will rise to the level of being considered having “provided advice” to a compensation committee.

In 2013, the SEC staff engaged in discussions with representatives of the American Bar Association Joint Committee on Employee Benefits [JCEB] regarding examples:

- where a listed issuer’s outside legal counsel is involved in the preparation and/or review of the executive compensation disclosure required by Item 402 of Regulation S-K for inclusion in the issuer’s proxy statement (and, via incorporation by reference, the issuer’s annual report on Form 10-K), including the drafting and/or review of the Compensation Discussion and Analysis and the required compensation tables; and

- where pursuant to its engagement with the listed issuer, its outside legal counsel provides advice to the issuer’s general counsel on an executive compensation matter and (1) the legal counsel has no reason to believe that its name (or any reference to having consulted with outside legal counsel) is being invoked when the general counsel subsequently provides advice to the compensation committee on the matter and/or (2) the Compensation Committee has no reason to believe that the general counsel would be consulting with outside legal counsel in connection with advising the Compensation Committee on the matter.

It was reported that the staff and the members of the JCEB in attendance engaged in a lengthy discussion on what it means to “provide advice” as contemplated by the Instruction to Rule 10C-1(b)(4), particularly as it relates to outside legal counsel. While the staff declined to provide a “bright line” test on the matter, several scenarios were presented and explored on the possible factors that may need to be analyzed in determining when a listed issuer’s outside legal counsel (or other outside adviser) is indirectly “providing advice” to a compensation committee.

Subsequently, at a meeting of the Securities Law Committee of the Society of Corporate Secretaries and Governance Professionals, the staff clarified its views on this matter in response to certain statements made following the JCEB-SEC staff meeting as to the substance of this discussion. The staff indicated that, while the question does not lend itself to a “bright line” test, in-house legal counsel should be in the best position to make the determination and control the vetting process. For example, if in-house legal counsel has a lawyer outside the door of the compensation committee meeting and goes out and gets advice and then comes back in and transmits that advice, then obviously that adviser should have been
vetted. The staff called this the “ventriloquist” scenario. On the other hand, if in-house legal counsel speaks to several outside legal counsel as a matter of course and then is in a compensation committee meeting giving advice based on what he or she has heard and formulated in his or her own mind, this situation would not require that these counsel be vetted.

For everything else—including the more realistic scenario of in-house legal counsel talking to one outside law firm on a regular basis—the listed issuer must use its judgment as to whether, based on the relevant facts and circumstances, a party is providing advice to the compensation committee and, thus, an independence assessment is required. *

The committee’s authority to engage and compensate advisers and its responsibility to assess adviser independence must be set forth in the committee’s charter. The rules do not require the committee to obtain or act consistently with the advice of an adviser nor do they require that an adviser be independent.

“Smaller reporting companies” are exempt from the requirement to consider the enumerated independence factors, but must have the expanded authority and funding to engage compensation advisers.

**§ 4A:4.6 Delegation**

The rules permit delegation to subcommittees. Companies should consider expressly allowing the compensation committee to delegate the approval of transactions to a subcommittee where necessary to satisfy the approval requirements of Rule 16b-3 under the Exchange Act and/or section 162(m) of the Internal Revenue Code.

Each of Rule 16b-3 and section 162(m) provides for actions to be taken by non-employee or outside directors in connection with certain compensation matters. Rule 16b-3 provides an exemption from short-swing profit recovery under section 16 of the Exchange Act for, among other things, transactions between issuers and their directors and officers that are approved by a committee of the board that consists solely of two or more “non-employee directors.” Section 162(m) exempts certain performance-based compensation from the cap on deductibility if a compensation committee composed of two or more “outside directors” determines and certifies the relevant performance goals. Because the criteria set forth in Rule 16b-3 and section 162(m) vary somewhat from the NYSE independence

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requirements, it is possible for a compensation committee member who is independent for NYSE purposes to fail to be a “non-employee director” under Rule 16b-3 or an “outside director” under section 162(m). In that case, delegation to a subcommittee composed of directors meeting the relevant definition would be necessary to meet the requirements of these provisions.\textsuperscript{11} Chapter 4B discusses the independence requirements of Rule 16b-3 and section 162(m) in more detail.

The NYSE listing standards expressly permit the responsibilities of the compensation committee to be allocated to one or more other committees composed entirely of independent directors. These other committees would need to have written charters posted on the company’s website, including the provisions required for the compensation committee’s charter.

\section{Nasdaq Listing Requirements}

The text of the Nasdaq rules relating to compensation committee responsibilities and authority is set forth in section 4A:2.2.

The Nasdaq rules, which were initially adopted in 2003 as part of the Nasdaq’s enhanced corporate governance listing standards, require each listed company to establish a compensation committee composed entirely of independent directors.\textsuperscript{12} See section 1A:3 for a discussion of the background and adoption of the enhanced stock exchange listing standards in 2003.

Initially, Nasdaq adopted rules requiring oversight by independent directors of executive officer compensation but not requiring a compensation committee. In 2010, section 952 of the Dodd-Frank Act added section 10C to the Exchange Act, requiring that listing standards incorporate requirements for compensation committees and related enhancements. In June 2012, the SEC adopted Rule 10C-1 to implement section 952. The rule closely tracked the requirements of section 952 and left most of the important details to the exchanges to propose.

The implementing stock exchange rules were approved in January 2013 and went into effect in July 2013.

\textsuperscript{11} See the section entitled “Delegation to Subcommittee” in the sample Compensation Committee Charter contained in section 4A:3.1 for suggested language specifically permitting this delegation.

\textsuperscript{12} See Rel. No. 34-48745, supra note 5.
§ 4A:5.1  Entities Subject to the Rules

The Nasdaq rules relating to compensation committee responsibility and authority generally apply to all U.S. companies with stock listed on the Nasdaq Stock Market. They, however, do not apply to:

- Controlled companies
- Limited partnerships
- SEC-registered management investment companies
- Asset-backed issues and other passive business organizations in the form of trusts or other unincorporated associations (such as royalty trusts)
- Certain member-owned cooperatives listing their preferred stock

A “smaller reporting company” must have a formal written compensation committee charter or board resolution that specifies the committee’s responsibilities and authority set forth in Rule 5605(d)(1)(A)–(C). However, smaller reporting companies are not required to incorporate into their formal written compensation committee charter or board resolution the specific compensation committee responsibilities and authority set forth in Rule 5605(d)(3).

See section 1A:4 for additional details regarding entities subject to the Nasdaq corporate governance rules.

§ 4A:5.2  Timing of Effectiveness and Phase-Ins

Companies subject to the Nasdaq rules relating to compensation committee responsibility and authority are generally required to comply at the time of listing. Although a grace period is provided with respect to the independent member requirements, it does not apply to the other aspects of the Nasdaq’s rules relating to compensation committees.

A company that ceases to be a smaller reporting company must, within six months of the beginning of the fiscal year after it determines it is no longer a smaller reporting company, comply with Nasdaq Rule 5605(d)(3) and certify to Nasdaq that: (1) it has complied with the requirement in Rule 5605(d)(1) to adopt a formal written compensation committee charter including the content specified in Rule 5605(d)(1)(A)–(D); and (ii) it has complied, or within the applicable phase-in schedule will comply, with the addi-
Compensation Committee Responsibilities and Authority § 4A:5.4

A Nasdaq-listed “foreign private issuer” is permitted to follow home country corporate governance practices related to compensation committees without the need to seek an individual exemption from Nasdaq. Nasdaq’s rules require a foreign private issuer, in its annual reports on Form 20-F or 40-F filed with the SEC or, if none is filed, on its website (and, for a newly listed company, in its registration statement or on its website), to disclose each corporate governance requirement it does not follow and to include a brief statement of the alternative home country practice it follows. In addition, as discussed in chapter 4B, if a foreign private issuer does not have an independent compensation committee, it must disclose in its annual report why it does not.

§ 4A:5.4 Charter and Responsibilities

Prior to effectiveness of the new rules approved in January 2013, Nasdaq corporate governance rules required that the compensation of the CEO and officers of each listed company be determined, or recommended to the board for determination, by either (1) a majority of the independent directors, or (2) a compensation committee composed solely of independent directors.

Under the new rules, beginning on the earlier of the listed company’s first annual meeting after January 15, 2014, or October 31, 2014, a listed company must have a standing compensation committee and a formal written compensation committee charter, which must be reviewed by the committee on an annual basis and must specify:

- the scope of the committee’s responsibilities and how it carries out those responsibilities;

14. Pursuant to Rule 12b-2 under the Exchange Act, a Company tests its status as a smaller reporting company on an annual basis as of the last business day of its most recently completed second fiscal quarter.


16. “Officer” is defined by reference to Rule 16a-1 under the Exchange Act as “an issuer’s president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer.”
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the committee’s responsibility for determining, or recommending to the board for determination, executive officer compensation;

that the chief executive officer may not be present during voting or deliberations by the committee on his or her compensation; and

the specific compensation committee responsibilities as to authority over retaining and compensating compensation advisers and responsibility to assess an adviser’s independence before selecting or receiving advice from such adviser.

§ 4A:5.5 Compensation Committee Advisers

In addition, the Nasdaq rule changes approved in January 2013 require that the committee charter must provide that the committee has broad authority and appropriate funding, as determined by the committee, to engage compensation consultants, outside legal counsel and other compensation advisers. Committees are required to consider the six independence factors enumerated in Rule 10C-1(b)(4) before selecting or receiving advice from an adviser, unless the adviser is in-house counsel or is only providing services limited to:

- consulting on any broad-based, non-discriminatory plan that is generally available to all salaried employees; and/or
- providing information that is either not customized for the listed company or is customized based on parameters that are not developed by the adviser and about which the adviser does not provide advice.

The independence factors set forth in section 10C of the Exchange Act, and duplicated in Rule 10C-1(b)(4) and the implementing stock exchange rules, are:

- the provision of other services to the listed company by the consultant or other adviser;
- the amount of fees received from the listed company by the consultant or other adviser, as a percentage of the total revenue of the consultant or other adviser;
- the policies and procedures of the consultant or other adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the consultant or other adviser with a member of the compensation committee; and
- any stock of the listed company owned by the consultant or other adviser.
In its final rules, the SEC introduced a sixth independence factor:

- any business or personal relationship between the executive officers of the issuer and the compensation adviser or the person employing the adviser.

Although it is reasonably clear that where a compensation committee seeks to directly engage a compensation consultant, legal counsel, or other adviser, that the subject adviser should expect that, during the course of its engagement, it will provide advice to the compensation committee, it is less clear, particularly in the case of legal counsel that has been engaged by the listed issuer itself, when its work for the issuer will rise to the level of having “provided advice” to a compensation committee.

In 2013, the staff engaged in discussions with representatives of the American Bar Association JCEB regarding examples:

- where a listed issuer’s outside legal counsel is involved in the preparation and/or review of the executive compensation disclosure required by Item 402 of Regulation S-K for inclusion in the issuer’s proxy statement (and, via incorporation by reference, the issuer’s annual report on Form 10-K), including the drafting and/or review of the Compensation Discussion and Analysis and the required compensation tables; and

- where pursuant to its engagement with the listed issuer, its outside legal counsel provides advice to the issuer’s general counsel on an executive compensation matter and (1) the legal counsel has no reason to believe that its name (or any reference to having consulted with outside legal counsel) is being invoked when the general counsel subsequently provides advice to the compensation committee on the matter and/or (2) the Compensation Committee has no reason to believe that the general counsel would be consulting with outside legal counsel in connection with advising the Compensation Committee on the matter.

It was reported that the staff and the members of the JCEB in attendance engaged in a lengthy discussion on what it means to “provide advice” as contemplated by the Instruction to Rule 10C-1(b)(4), particularly as it relates to outside legal counsel. While the staff declined to provide a “bright line” text on the matter, several scenarios were presented and explored on the possible factors that may need to be analyzed in determining when a listed issuer’s outside legal counsel (or other outside adviser) is indirectly “providing advice” to a compensation committee.

Subsequently, at a meeting of the Securities Law Committee of the Society of Corporate Secretaries and Governance Professionals, the staff clarified its views on this matter in response to certain
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statements made following the JCEB-SEC staff meeting as to the substance of this discussion. The staff indicated to the Society that, while the question does not lend itself to a “bright line” test, in-house legal counsel should be in the best position to make the determination and control the vetting process. For example, if in-house legal counsel has a lawyer outside the door of the compensation committee meeting and goes out and gets advice and then comes back in and transmits that advice, then obviously that adviser should have been vetted. The staff called this the “ventriloquist” scenario. On the other hand, if in-house legal counsel speaks to several outside legal counsel as a matter of course and then is in a compensation committee meeting giving advice based on what he or she has heard and formulated in his or her own mind, this situation would not require that these counsel be vetted.

For everything else—including the more realistic scenario of in-house legal counsel talking to one outside law firm on a regular basis—the listed issuer must use its judgment as to whether, based on the relevant facts and circumstances, a party is providing advice to the compensation committee and, thus, an independence assessment is required.17

The committee’s authority to engage and compensate advisers and its responsibility to assess adviser independence must be set forth in the committee’s charter. The rules do not require the committee to obtain or act consistently with the advice of an adviser nor do they require that an adviser be independent.

§ 4A:5.6  Delegation

Unlike the NYSE rules, the Nasdaq rules do not specifically state that delegation to a subcommittee is permitted. The wording of the requirement would, however, permit delegation, since a subcommittee of an independent compensation committee would necessarily be a committee composed of independent directors. In particular, the rules would seem to permit a standing independent compensation committee to delegate responsibilities to a subcommittee composed of directors satisfying the standards of Rule 16b-3 under the Exchange Act and/or section 162(m) of the Internal Revenue Code.18


18. See section 4A:4.6 for a discussion of Rule 16b-3 and § 162[m] and the reasons delegation may be necessary. See the section entitled “Delegation to Subcommittee” in the Sample Compensation Committee Charter contained in section 4A:3.2 for suggested language specifically permitting this delegation.

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