Silver, Freedman & Taff, L.L.P.
"Finding solutions every day"

March 2013

AMENDMENTS TO NASDAQ RULES ON COMPENSATION COMMITTEES

Summary. The Securities and Exchange Commission recently approved the following amendments to the NASDAQ listing rules relating to compensation committees:

- Effective July 1, 2013, a company's compensation committee must have certain responsibilities and authority relating to the retention of compensation consultants, legal counsel and other advisors to the committee ("compensation advisers"), including a requirement to consider specified factors before retaining or receiving advice from a compensation adviser.

- Effective on the earlier of (i) the company's first annual meeting after January 15, 2014 or (ii) October 31, 2014, a compensation committee must have a charter (if it does not have one already) specifying certain items, including the committee's responsibilities and authority relating to the retention of compensation advisers.

- Effective on the earlier of (i) the company's first annual meeting after January 15, 2014 or (ii) October 31, 2014, a company must have a formal compensation committee with two or more members and can no longer fulfill the compensation committee function by a majority vote of independent directors. As of the applicable effective date, in addition to being an "independent director" under the general definition of that term in the NASDAQ rules, a compensation committee member may not, while serving on the compensation committee, accept directly or indirectly any "consulting, advisory or other compensatory fee" from the company, other than fees for board or committee service or fixed amounts under a retirement plan for prior service with the company.

There are partial exemptions for smaller reporting companies. Set forth below is a discussion of the amendments. Exhibit A to this memorandum contains a chart summarizing the steps that must be taken by the applicable deadlines.

If you have any questions concerning the materials discussed in this article, please feel free to contact any of our attorneys listed below.

James S. Fleischer	**(202) 295-4507**	Jim@sftlaw.com
Craig M. Scheer	**(202) 295-4525**	Craig@sftlaw.com

SFT

Silver, Freedman & Taff, L.L.P.

"Finding solutions every day"

New Compensation Committee Responsibilities and Authority

Effective **July 1, 2013**, a compensation committee must have the following specific responsibilities and authority:

- the compensation committee may, in its sole discretion, retain or obtain the advice of a compensation adviser;
- the compensation committee must be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee;
- the company must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to a compensation adviser retained by the compensation committee;
- <u>before</u> selecting, or receiving advice from, a compensation adviser, other than in-house legal counsel, the compensation committee must conduct an independence assessment by considering the following six factors:
    - the provision of other services to the company by the person that employs the compensation adviser;
    - the amount of fees received from the company by the person that employs the compensation adviser, as a percentage of the total revenue of the person that employs the compensation adviser;
    - the policies and procedures of the person that employs the compensation adviser that are designed to prevent conflicts of interest;
    - any business or personal relationship of the compensation adviser with a member of the compensation committee;
    - any stock of the company owned by the compensation adviser; and
    - any business or personal relationship of the compensation adviser or the person employing the adviser with an executive officer of the company.

The compensation committee must conduct the independence assessment with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than (1) in-house legal counsel or (2) an adviser whose role is limited to (i) consulting on any plan that does not discriminate in favor of executive officers or directors and that is available generally to all salaried employees or (ii) providing information that either is not customized for the company or that is customized based on parameters that are not developed by the adviser, and about which the adviser does not provide advice. An independence assessment would be required for the company's outside legal counsel if it provides advice to the compensation committee. In its order approving the amendments to the NASDAQ rules, the SEC indicated that it expects that these assessments will be conducted at least annually.

The rules do not specify how the compensation committee is supposed to conduct the independence assessment, though one possibility would be for each compensation adviser to complete a questionnaire covering the six independence factors above. There is no requirement that a compensation adviser actually be "independent," only that the compensation committee have considered the six independence factors before selecting, or receiving advice from, a compensation adviser. The committee may utilize any compensation adviser that it prefers, as long as it has considered the six independence factors.

As noted above, a company's compensation committee must have the specific responsibilities and authority relating to compensation advisers by July 1, 2013. While the most logical means of accomplishing this may be to amend the compensation committee charter by that date (or adopt a charter by that date, if the compensation committee does not already have one), a company can instead adopt a board resolution for this prior to July 1, 2013 and defer amending the charter until the date by which the company must comply with the new compensation committee charter requirement (see below). If the company does not have a formal compensation committee and fulfills the compensation committee function by majority vote of the independent directors, then the independent directors must be conferred with the responsibilities and authority relating to compensation advisers. As noted below under "Changes to Compensation Committee Composition Requirements," effective on the earlier of (i) the company's first annual meeting after January 15, 2014 or (ii) October 31, 2014, a company must have a formal compensation committee.

Compensation committees of smaller reporting companies need not be provided with the responsibilities and authority relating to compensation advisers.

Compensation Committee Charter

While SEC rules require a company to disclose whether or not it has a compensation committee charter, there is no requirement under current NASDAQ rules to actually have one. Under the amended NASDAQ rules, **by the <u>earlier</u> of (i) the company's first annual meeting after January 15, 2014 or (ii) October 31, 2014**, a company must have a compensation committee charter and the compensation committee must review and assess the adequacy of the charter on an annual basis. The charter must specify:

- the scope of the compensation committee's responsibilities, and how it carries out those responsibilities, including structure, processes and membership requirements;
- the compensation committee's responsibility for determining, or recommending to the board for determination, the compensation of the CEO and all other executive officers;

- that the CEO may not be present during voting or deliberations on his or her compensation; and

- the specific compensation responsibilities and authority relating to compensation advisers, as described above under "New Compensation Committee Responsibilities and Authority."

A smaller reporting company may adopt a board resolution specifying the items in the first three bullet points above in lieu of having a compensation committee charter. The fourth item need not be included in the compensation committee charter or board resolution of a smaller reporting company, as smaller reporting companies are exempt from the requirement of giving the compensation committee the responsibilities and authority relating to compensation advisers.

Changes to Compensation Committee Composition Requirements

Under current NASDAQ rules, compensation of executive officers must be approved, or recommended to the board for its approval, by a committee comprised solely of "independent directors" (under the general definition of that term in the NASDAQ rules) or by a majority of the independent directors without the participation of any non-independent directors. There currently is no requirement that the board actually have a compensation committee. Nor is there a minimum on the number of directors comprising a compensation committee, should a board choose to have one.

Under the amended NASDAQ rules, effective beginning on **the <u>earlier</u> of (i) the company's first annual meeting after January 15, 2014 or (ii) October 31, 2014**, a company's board must have a compensation committee comprised of two or more members. Each compensation committee member must (1) be an independent director <u>and</u> (2) not accept directly or indirectly any "consulting, advisory or other compensatory fee" from the company or any subsidiary of the company while serving on the compensation committee. A "compensatory fee" does not include fees for board or committee service or the receipt of fixed amounts under a retirement plan (including deferred compensation) for prior service with the company that are not contingent on continued service.

The additional independence requirement for compensation committee members is substantially the same as the additional independence requirement currently in effect for audit committee members, but differs in one significant respect. An audit committee member cannot be an "affiliated person" of the company, which for all practical purposes precludes a director from serving on the audit committee if he or she is, or is associated with, a greater than 10% stockholder of the company. Under the amended NASDAQ rules, while a board must consider whether any such affiliation would impair the director's judgment as a member of the compensation committee, the affiliation alone does not preclude the director from serving on the compensation committee. NASDAQ noted that it may be appropriate for representatives of significant stockholders to serve on the compensation committee, since their interests are likely aligned with those of stockholders generally on executive compensation matters.

A smaller reporting company will be required to have a compensation committee of two or more members, and will no longer be able to fulfill this function by vote of a majority of the independent directors. Smaller reporting companies will, however, be exempt from the additional independence requirement prohibiting a compensation committee member from accepting any consulting, advisory or other compensatory fee from the company and from the requirement that the board consider the affiliated status of a director before appointing him or her to the compensation committee.

Silver, Freedman & Taff, L.L.P.
"Finding solutions every day"

Exhibit A

Steps to be Taken Under
Amendments to NASDAQ Rules

	All Companies Other Than Smaller Reporting Companies	Smaller Reporting Companies
By July 1, 2013	Give compensation committee responsibilities and authority relating to the retention of compensation advisers, including requirement to consider specified independence factors before retaining or receiving advice from a compensation adviser. Do this either by adopting or amending the committee's charter or adopting a board resolution.	Not required.
By earlier of (i) first annual meeting after January 15, 2014 or (ii) October 31, 2014	Compensation committee must have a charter (if it does not have one already) specifying certain items, including the committee's responsibilities and authority relating to the retention of compensation advisers.	Compensation committee must have a charter (if it does not have one already) or board resolution specifying the same items, except for responsibilities and authority relating to the retention of compensation advisers, as this is not required for smaller reporting companies.
By earlier of (i) first annual meeting after January 15, 2014 or (ii) October 31, 2014	Must have a formal compensation committee with two or more members and can no longer fulfill the compensation committee function by a majority vote of independent directors.	Same.

	All Companies Other Than Smaller Reporting Companies	Smaller Reporting Companies
By earlier of (i) first annual meeting after January 15, 2014 or (ii) October 31, 2014	Each compensation committee member (1) must be an "independent director" and (2) cannot, while serving on the committee, accept directly or indirectly any "consulting, advisory or other compensatory fee" from the company, other than fees for board or committee service or fixed amounts under a retirement plan for prior service with the company. In addition, in assessing the eligibility of a director to serve on the compensation committee, the board must consider whether the director is affiliated with the company (e.g., as, or as a nominee of, a large stockholder) and whether any such affiliation would impair the director's judgment as a compensation committee member.	Only requirement is that each compensation committee member be an "independent director."