

proposed rule change, SR-NYSEMKT-2012-48, as modified by Amendment Nos. 1 and 3, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>192</sup>

Kevin M. O'Neill,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68640; File No. SR-NASDAQ-2012-109]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Amendment Nos. 1 and 2, and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment Nos. 1 and 2 To Amend the Listing Rules for Compensation Committees To Comply With Rule 10C-1 Under the Act and Make Other Related Changes

January 11, 2013.

#### I. Introduction

On September 25, 2012, The NASDAQ Stock Market LLC ("Nasdaq" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to modify the Exchange's rules for compensation committees of listed issuers to comply with Rule 10C-1 under the Act and make other related changes. The proposed rule change was published for comment in the **Federal Register** on October 15, 2012.<sup>3</sup> The Commission subsequently extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change, to January 13, 2013.<sup>4</sup> The Commission received eight comment letters on the proposed rule change,<sup>5</sup> as well as a

response to the comment letters from Nasdaq.<sup>6</sup> On December 12, 2012, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>7</sup> On January 4, 2013, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>8</sup> This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2 thereto, on an accelerated basis.

#### II. Description of Proposed Rule Change

##### A. Background: Rule 10C-1 Under the Act

On March 30, 2011, to implement Section 10C of the Act, as added by

Company Institute, dated November 1, 2012 ("ICI Letter"); Jeff Mahoney, General Counsel, Council of Institutional Investors, dated November 1, 2012 ("CII Letter"); Harold R. Carpenter, Chief Financial Officer, Pinnacle Financial Partners, Inc., dated November 5, 2012 ("Pinnacle Letter"); Brandon J. Rees, Acting Director, Office of Investment, AFL-CIO, dated November 5, 2012 ("AFL-CIO Letter"); Carin Zelenko, Director, Capital Strategies Department, International Brotherhood of Teamsters, dated November 5, 2012 ("Teamsters Letter"); Wilson Sonsini Goodrich & Rosati Professional Corporation, dated November 14, 2012 ("Wilson Sonsini Letter"); and Robert B. Lamm, Chair, Securities Law Committee, The Society of Corporate Secretaries & Governance Professionals, dated December 7, 2012 ("Corporate Secretaries Letter").

<sup>6</sup> See Letter to Elizabeth M. Murphy, Secretary, Commission, from Erika J. Moore, Associate General Counsel, Nasdaq, dated December 12, 2012 ("Nasdaq Response Letter").

<sup>7</sup> In Amendment No. 1, Nasdaq: (a) Added language to proposed Rule 5605(d)(3) to set forth in detail the requirements of Rule 10C-1(b)(2)-(4) regarding the authority of a compensation committee to retain compensation advisers, the requirement that a listed company fund such advisers, and the independence assessment required to be made before selecting or receiving advice from such advisers, rather than incorporating these details by reference as in the original proposal, *see infra* notes 51-58 and accompanying text; (b) revised the dates by which companies currently listed on Nasdaq will be required to comply with the new rules, *see infra* notes 73-79 and accompanying text; (c) revised the phase-in schedule for companies that cease to be Smaller Reporting Companies to comply with the full range of the new requirements, *see infra* notes 85-88 and accompanying text; and (d) added a preamble to the new rules clarifying that, during the transition periods until the new rules apply, a company must continue to comply with the corresponding provisions, if any, in the current rules, *see infra* note 73. In Amendment No. 1 the Exchange also made conforming changes to the Purpose section of the proposal, provided explanations for the revisions, and clarified certain matters, *see, e.g., infra* notes 58, 194, and 199 and accompanying text; and also added, as Exhibit 3 to the proposal, the form that it will provide for companies to certify their compliance with the rules.

<sup>8</sup> In Amendment No. 2, Nasdaq revised the proposed rules to state that the independence assessment of compensation advisers required of compensation committees does not need to be conducted for advisers whose roles are limited to those entitled to an exception from the adviser disclosure rules under Item 407(e)(3)(iii) of Regulation S-K. *See infra* notes 59-60 and accompanying text.

Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),<sup>9</sup> the Commission proposed Rule 10C-1 under the Act,<sup>10</sup> which directs each national securities exchange (hereinafter, "exchange") to prohibit the listing of any equity security of any issuer, with certain exceptions, that does not comply with the rule's requirements regarding compensation committees of listed issuers and related requirements regarding compensation advisers. On June 20, 2012, the Commission adopted Rule 10C-1.<sup>11</sup>

Rule 10C-1 requires, among other things, each exchange to adopt rules providing that each member of the compensation committee<sup>12</sup> of a listed issuer must be a member of the board of directors of the issuer, and must otherwise be independent.<sup>13</sup> In determining the independence standards for members of compensation committees of listed issuers, Rule 10C-1 requires the exchanges to consider relevant factors, including, but not limited to: (a) The source of compensation of the director, including any consulting, advisory or other compensatory fee paid by the issuer to the director (hereinafter, the "Fees Factor"); and (b) whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer (hereinafter, the "Affiliation Factor").<sup>14</sup>

In addition, Rule 10C-1 requires the listing rules of exchanges to mandate that compensation committees be given the authority to retain or obtain the advice of a compensation adviser, and have direct responsibility for the appointment, compensation and oversight of the work of any compensation adviser they retain.<sup>15</sup> The exchange rules must also provide that each listed issuer provide for appropriate funding for the payment of

<sup>9</sup> Public Law 111-203, 124 Stat. 1900 (2010).

<sup>10</sup> *See* Securities Act Release No. 9199, Securities Exchange Act Release No. 64149 (March 30, 2011), 76 FR 18966 (April 6, 2011) ("Rule 10C-1 Proposing Release").

<sup>11</sup> *See* Securities Act Release No. 9330, Securities Exchange Act Release No. 67220 (June 20, 2012), 77 FR 38422 (June 27, 2012) ("Rule 10C-1 Adopting Release").

<sup>12</sup> For a definition of the term "compensation committee" for purposes of Rule 10C-1, *see* Rule 10C-1(c)(2)(i)-(iii).

<sup>13</sup> *See* Rule 10C-1(a) and (b)(1).

<sup>14</sup> *See id.* *See also* Rule 10C-1(b)(1)(iii)(A), which sets forth exemptions from the independence requirements for certain categories of issuers. In addition, an exchange may exempt a particular relationship with respect to members of a compensation committee from these requirements as it deems appropriate, taking into consideration the size of an issuer and any other relevant factors. *See* Rule 10C-1(b)(1)(iii)(B).

<sup>15</sup> *See* Rule 10C-1(b)(2).

<sup>192</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> *See* Securities Exchange Act Release No. 68013 (October 9, 2012), 77 FR 62563 ("Notice").

<sup>4</sup> *See* Securities Exchange Act Release No. 68313 (November 28, 2012), 77 FR 71853 (December 4, 2012).

<sup>5</sup> *See* Letters to Elizabeth M. Murphy, Secretary, Commission, from: J. Robert Brown, Jr., Director, Corporate & Commercial Law Program, University of Denver Sturm College of Law, dated October 30, 2012 ("Brown Letter"); Dorothy Donohue, Deputy General Counsel, Securities Regulation, Investment

reasonable compensation, as determined by the compensation committee, to any compensation adviser retained by the compensation committee.<sup>16</sup> Finally, among other things, Rule 10C-1 requires each exchange to provide in its rules that the compensation committee of each listed issuer may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration six factors specified in Rule 10C-1,<sup>17</sup> as well as any other factors identified by the relevant exchange in its listing standards.<sup>18</sup>

#### B. Nasdaq's Proposed Rule Change, as Amended

To comply with Rule 10C-1, Nasdaq proposes to amend two sections of its rules concerning corporate governance requirements for companies listed on the Exchange: Rule 5605, "Boards of Directors and Committees," and Rule 5615, "Exemptions from Certain Corporate Governance Requirements." In addition, Nasdaq proposes to make some other changes to its rules regarding compensation committees.

To accomplish these changes, the Exchange proposes to replace current paragraph (d) of Rule 5605, entitled "Independent Director Oversight of Executive Officer Compensation," with a new paragraph (d) entitled "Compensation Committee Requirements." Current paragraph (d) provides that compensation of the executive officers of a listed company must be determined, or recommended to the company's board for determination, either by a compensation committee comprised solely of "Independent Directors"<sup>19</sup>; or, as an alternative to a formal committee, by a majority of the board's Independent Directors in a vote

in which only Independent Directors participate ("Alternative Option").<sup>20</sup>

#### 1. Compensation Committee Composition and Independence Standards

First, Nasdaq proposes that each listed company be required to have a compensation committee.<sup>21</sup> The Alternative Option described above would be eliminated. In addition, Nasdaq proposes that the compensation committee be required to be composed of at least two members, each of whom must be an Independent Director as defined in Nasdaq's rules and also meet the additional independence requirements described below.<sup>22</sup>

In discussing the proposed elimination of the Alternative Option, Nasdaq stated that it had considered whether the Alternative Option remains appropriate, "given the heightened importance of compensation decisions in today's corporate governance environment." The Exchange concluded that "there are benefits from a board having a standing committee dedicated solely to oversight of executive compensation."<sup>23</sup> In discussing the proposed requirement that the committee have at least two members, the Exchange stated that "[g]iven the importance of compensation decisions to stockholders, Nasdaq believes that it is appropriate to have more than one director responsible for these decisions."<sup>24</sup>

Nasdaq also proposes that a compensation committee must have a formal written charter.<sup>25</sup> Under this provision, a listed company must certify that it has adopted such a charter and that its compensation committee will review and reassess the adequacy of that charter on an annual basis.<sup>26</sup>

The charter must specify the scope of the committee's responsibilities and how it carries out those responsibilities, including structure, processes, and membership requirements.<sup>27</sup> It must specify the committee's responsibility for determining or recommending to the board for determination, the compensation of the CEO and all other executive officers of the company, and provide that the CEO may not be present during voting or deliberations on his or her compensation.<sup>28</sup> In addition, the charter must specify the committee's responsibilities and authority set forth in the Exchange's rules with respect to retaining its own advisers; appointing, compensating, and overseeing such advisers; considering certain independence factors before selecting advisers; and receiving funding from the company to engage them, which are discussed in detail below.<sup>29</sup>

Nasdaq's rules currently require each member of a listed company's compensation committee to be an Independent Director as defined in Nasdaq Rule 5605(a)(2).<sup>30</sup> Rule 10C-1, as discussed above, provides that exchange standards must require compensation committee members to be independent, and further provides that each exchange, in determining independence for this purpose, must consider relevant factors, including the Fees Factor and Affiliation Factor described above. In its proposal, Nasdaq discussed its consideration of these factors,<sup>31</sup> and proposed the following<sup>32</sup>:

listed issuers will specify authority and responsibilities of this kind in a charter in any case. The proposed rule requires them to have a charter, and to include this authority and set of responsibilities in addition to the required content discussed *infra* at text accompanying notes 27-29.

<sup>27</sup> Proposed Rule 5605(d)(1)(A). Nasdaq states that this requirement is copied from the Exchange's similar listing rule relating to audit committee charters, Rule 5605(c)(1), except that the annual review and reassessment requirement is written prospectively, rather than retrospectively. The proposed rule change includes a conforming revision to make the audit committee review and reassessment prospective, as well. See Notice.

<sup>28</sup> Proposed Rule 5605(d)(1)(B)-(C). Nasdaq states that these provisions are based upon Nasdaq's current compensation-related listing rules, except that the Alternative Option discussed above is not available under the proposed rule change. See *supra* note 21 and accompanying text.

<sup>29</sup> See proposed Rule 5605(d)(1)(D) and *infra* notes 49-58 and accompanying text. Because Smaller Reporting Companies are not required to comply with the provisions relating to compensation advisers in proposed Nasdaq Rule 5605(d)(3), see *infra* notes 62-67, their charters or board resolutions are not required to reflect these responsibilities.

<sup>30</sup> See *supra* note 19.

<sup>31</sup> Notice, *supra* note 3.

<sup>32</sup> These additional factors would not apply to the selection of members of the compensation

Continued

<sup>16</sup> See Rule 10C-1(b)(3).

<sup>17</sup> See Rule 10C-1(b)(4). The six factors, which Nasdaq proposes to set forth explicitly in its rules, are specified in the text accompanying note 55, *infra*.

<sup>18</sup> Other provisions in Rule 10C-1 relate to exemptions from the rule and a requirement that each exchange provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for the exchange, under Rule 10C-1, to prohibit the issuer's listing.

<sup>19</sup> "Independent Directors," as defined in Nasdaq Rule 5605(a)(2) and used herein, includes a two-part test for independence. The rule sets forth seven specific categories of directors who cannot be considered independent because of certain discrete relationships ("the bright-line tests"); and also provides that a listed company's board must make an affirmative determination that each independent director has no relationship that, in the opinion of the board, "would interfere with the exercise of independent judgment in carrying out the responsibilities of a director." *Id.* See also the Interpretive Material to Rule 5605.

<sup>20</sup> The current rule also provides that the chief executive officer ("CEO") may not be present during voting or deliberations regarding the CEO's own compensation. See Rule 5605(d)(1).

<sup>21</sup> See proposed Rule 5605(d)(2).

<sup>22</sup> *Id.* For the definition of "Independent Director," see *supra* note 19.

<sup>23</sup> See Notice, *supra* note 3, for the Exchange's more complete explanation of its reasons for the proposed change, including a discussion of whether eliminating the Alternative Option would pose an undue hardship on Nasdaq-listed companies.

<sup>24</sup> See *id.* for the Exchange's more complete discussion of the proposed size requirement.

<sup>25</sup> See proposed Nasdaq Rule 5605(d)(1). As discussed further in Section II.B.3., a Smaller Reporting Company may adopt either a formal written compensation committee charter or a board resolution that specifies the committee's responsibilities and authority.

<sup>26</sup> The Commission notes that Rule 10C-1 does not require a listed issuer specifically to have a charter. As noted above, however, see *supra* notes 15-17 and accompanying text, Rule 10C-1 does require a compensation committee to have certain specified authority and responsibilities. Often,

With respect to the Fees Factor, Nasdaq proposes to adopt a provision stating that each member of a compensation committee of a listed company must not accept directly or indirectly any consulting, advisory or other compensatory fee from the listed company or any of its subsidiaries.<sup>33</sup> In discussing its review of its current listing rules and the Fees Factor, Nasdaq noted that its rules for audit committees of listed companies, in meeting the criteria of Rule 10A-3 under the Act, prohibit an audit committee member from accepting such fees. The Exchange concluded that “there is no compelling justification to have different standards for audit and compensation committee members” with respect to the Fees Factor.<sup>34</sup>

As currently permitted under Nasdaq’s rules for audit committee members, however, the proposed rule would permit a compensation committee member to receive fees for his or her membership on the committee, on the company’s board, or on any other board committee.<sup>35</sup> In addition, a compensation committee member would be permitted to receive fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company, provided that such compensation is not contingent in any way on continued service.<sup>36</sup>

With respect to the Affiliation Factor, Nasdaq proposes that, in determining whether a director is eligible to serve on the compensation committee, the company’s board also must consider whether the director is affiliated with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company to determine whether such affiliation would impair the director’s judgment as a member of the compensation committee.<sup>37</sup> In discussing its review of its current rules and its consideration of the Rule 10C-1 requirement in this area,<sup>38</sup> the Exchange noted that its rules for audit committees of listed companies, in meeting the criteria of Rule 10A-3 under the Act, prohibit an audit committee member from being an affiliated person of the issuer or any subsidiary thereof. The Exchange said that it concluded, however, that “such a blanket prohibition would be inappropriate for compensation

committees.”<sup>39</sup> Nasdaq believes that “it may be appropriate for certain affiliates, such as representatives of significant stockholders, to serve on compensation committees since their interests are likely aligned with those of other stockholders in seeking an appropriate executive compensation program.”<sup>40</sup>

Although Rule 10C-1 requires that exchanges consider “relevant factors” not limited to the Fees and Affiliation Factors, Nasdaq states that, after reviewing its current and proposed listing rules, it concluded that these rules are sufficient to ensure the independence of compensation committee members. The Exchange therefore determined not to propose further independence requirements.<sup>41</sup>

Nasdaq proposes a cure period for a failure of a listed company to meet its committee composition requirements. The proposed cure period is the same as the cure period currently provided in Nasdaq’s rules for noncompliance with the requirement to have a majority independent board.<sup>42</sup> Under the provision, if a listed company fails to comply with the compensation committee composition requirements due to one vacancy, or if one compensation committee member ceases to be independent due to circumstances beyond the member’s reasonable control, the company must regain compliance by the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the noncompliance.<sup>43</sup>

However, if the annual shareholders meeting occurs no later than 180 days following the event that caused the noncompliance, the company instead has 180 days from the event to regain compliance. As explained by Nasdaq, this provides a company at least 180 days to cure noncompliance and would typically allow a company to regain compliance in connection with its next annual meeting.<sup>44</sup> The proposed rule also requires a company relying on this provision to provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the noncompliance.

Nasdaq’s current rules relating to compensation committees include an exception that allows a director who is not an Independent Director to be appointed to such a committee under exceptional and limited circumstances,

as long as that director is not currently an executive officer, an employee, or the family member of an executive officer.<sup>45</sup> The exception applies, however, only if the committee is comprised of at least three members and the company’s board determines that the individual’s membership on the committee is required by the best interests of the company and its shareholders.<sup>46</sup> The exception is retained under the proposed rule change, and permits a listed company to avail itself of the allowance even for a director who fails the new requirements regarding the Fees and Affiliation Factors.<sup>47</sup> A compensation committee member may not serve longer than two years under this exception. In addition, a company relying on the exception must make certain disclosures on its Web site or in its proxy statement regarding the nature of the relationship and the reasons for the determination.

In its discussion of this provision,<sup>48</sup> Nasdaq notes that its rules for audit committees and nominations committees of listed companies also include such an exception. The Exchange states that, while these exceptions are used infrequently by its listed companies, it believes that they are an important means to allow companies flexibility as to board and committee membership and composition in unusual circumstances. The Exchange further believes that the exception may be particularly important for smaller companies.

## 2. Authority of Committees to Retain Compensation Advisers; Funding; and Independence of Compensation Advisers

In its proposed rule change, as modified by Amendment No. 1,<sup>49</sup> Nasdaq proposes to fulfill the requirements imposed by Rule 10C-1(b)(2)-(4) under the Act by setting forth those requirements in full in its own rules.<sup>50</sup> Thus, proposed Nasdaq Rule 5605(d)(3), as amended, provides that the compensation committee of a listed company may, in its sole discretion,

<sup>45</sup> See current Rule 5605(d)(3).

<sup>46</sup> See *id.*

<sup>47</sup> See proposed Rule 5605(d)(2)(b).

<sup>48</sup> See Notice.

<sup>49</sup> See *supra* note 7. Nasdaq’s proposal as submitted originally incorporated the requirements of Rule 10C-1(b)(2)-(4) by reference. The Exchange amended the proposal to set forth those requirements explicitly.

<sup>50</sup> Rule 10C-1(b)(4) does not include the word “independent” before “legal counsel” and requires an independence assessment for any legal counsel to a compensation committee, other than in-house counsel. In setting forth the requirements of Rule 10C-1(b)(2) and (3), Nasdaq has deleted the word “independent” prior to “legal counsel” so as to avoid confusion.

committee of a Smaller Reporting Company. See *infra* note 64.

<sup>33</sup> See proposed Rule 5605(d)(2)(A).

<sup>34</sup> See Notice.

<sup>35</sup> See *supra* note 33.

<sup>36</sup> *Id.*

<sup>37</sup> See proposed Rule 5605(d)(2)(A).

<sup>38</sup> See Notice.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> See Rule 5605(b)(1)(A) regarding the majority board requirement.

<sup>43</sup> See proposed Rule 5605(d)(4).

<sup>44</sup> See Notice.

retain or obtain the advice of a compensation consultant, legal counsel or other adviser.<sup>51</sup> Further, 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.<sup>52</sup> In addition, the listed 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.<sup>53</sup>

Proposed Nasdaq Rule 5605(d)(3), as amended, also sets forth explicitly, in accordance with Rule 10C-1, that the compensation committee may select, or receive advice from, a compensation consultant, legal counsel or other adviser to the compensation committee, other than in-house legal counsel, only after taking into consideration the six factors set forth in Rule 10C-1 regarding independence assessments of compensation advisers.<sup>54</sup>

The six factors, which are set forth in full in the proposed rule, are: (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.<sup>55</sup>

Proposed Rule 5605(d)(3), as amended, also clarifies that nothing in the 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.<sup>56</sup> It further clarifies that compensation committees may select, or receive advice from, any compensation adviser they prefer, including ones that are not independent, after considering the six independence factors set forth in the rule.<sup>57</sup> In Amendment No. 1, Nasdaq emphasizes that a compensation committee is not required to retain an independent compensation adviser; rather, a compensation committee is required only to conduct the independence analysis described in Rule 10C-1 before selecting a compensation adviser.<sup>58</sup>

In Amendment No. 2, Nasdaq added language to the provision regarding the independence assessment of compensation advisers<sup>59</sup> to state that 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.

Nasdaq states that this exception copies language from Item 407(e)(3)(iii) of Regulation S-K, which provides a limited exception to the Commission's requirement for a registrant to disclose any role of compensation consultants in determining or recommending the amount and form of a registrant's executive and director compensation.<sup>60</sup>

The Exchange believes that its proposed exception from the independence assessment requirement is appropriate because the types of services excepted do not raise conflict of interest concerns, and noted that this is the same reason for which the Commission excluded these types of services from the disclosure requirement in Item 407(e)(3)(iii) of Regulation S-K.<sup>61</sup>

### 3. Application to Smaller Reporting Companies

Rule 10C-1 includes an exemption for smaller reporting companies from all the requirements included within the rule.<sup>62</sup> Consistent with this Rule 10C-1 provision, Nasdaq, as a general matter, proposes that a smaller reporting company, as defined in Rule 12b-2 under the Act (hereinafter, a "Smaller Reporting Company"), not be subject to the new requirements set forth in its proposal specifically to comply with Rule 10C-1.<sup>63</sup> Thus, Nasdaq proposes not to require Smaller Reporting Companies to comply with the enhanced independence standards for members of compensation committees relating to compensatory fees and affiliation.<sup>64</sup>

In addition, a Smaller Reporting Company will not be required to include in its compensation committee charter (or, as discussed below, in a board resolution) a grant of authority to the committee to retain compensation advisers, a requirement that the company fund such advisers, and a requirement that the committee consider independence factors before selecting such advisers. As stated by Nasdaq, the exception for Smaller Reporting Companies also means that the compensation committees of such companies are not required to review and reassess the adequacy of their charters on an annual basis.<sup>65</sup> The Exchange believes that this approach will minimize new costs imposed on Smaller Reporting Companies and allow them some flexibility not allowed for larger companies.

Nasdaq proposes not to exclude a Smaller Reporting Company, however, from its proposal to require a listed

<sup>51</sup> See Item 9 of Amendment No. 1.

<sup>52</sup> See *id.* The proposal, as amended, also includes a provision, derived from Rule 10C-1, stating that nothing in these rules may 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. *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> See Rule 10C-1(b)(4).

<sup>55</sup> Rule 10C-1(b)(4)(i)-(vi).

<sup>56</sup> See *id.*

<sup>57</sup> See *id.*

<sup>58</sup> See Item 2 of Amendment No. 1.

<sup>59</sup> See proposed Rule 5605(d)(3), as amended by Amendment No. 2.

<sup>60</sup> See 17 CFR 229.407(e)(3)(iii).

<sup>61</sup> See Amendment No. 2.

<sup>62</sup> See *supra* Section II.A.

<sup>63</sup> See proposed Rule 5605(d)(5).

<sup>64</sup> See *supra* text accompanying notes 33 and 37.

<sup>65</sup> See Notice. In addition, a Smaller Reporting Company, like other listed companies, will be required to certify that it has adopted a formal written compensation committee charter (or, if it so chooses, a board resolution) that specifies the scope of the committee's responsibilities and its responsibility for determining or recommending to the board for determination the compensation of the CEO and other executive officers. See *supra* notes 27-28.

company to have, and to 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 in the Exchange's Rule 5605(a)(2).<sup>66</sup> In its discussion of the rules from which Smaller Reporting Companies are not exempt, Nasdaq notes that its current listing rules regarding compensation committees do not provide any exemptions for Smaller Reporting Companies.<sup>67</sup>

#### 4. Exemptions

Nasdaq proposes that its existing exemptions from the Exchange's compensation-related listing rules currently in place, which are set forth in Nasdaq Rule 5615, apply also to the new requirements of the proposed rule change. These include exemptions for asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies registered under the Investment Company Act of 1940 ("registered management investment companies"), and controlled companies.<sup>68</sup> Nasdaq states that each of these categories has "traditionally been exempt from Nasdaq's compensation-related listing rules," and believes that the reasons for the exemptions apply to the new requirements, as well.<sup>69</sup>

Asset-backed issuers and other passive issuers have been exempted, according to the Exchange, because they do not have a board of directors or persons acting in a similar capacity and their activities are limited to passively owning or holding (as well as administering and distributing amounts in respect of) assets on behalf of or for the benefit of the holders of the listed securities. Certain member-owned cooperatives have been exempt, the Exchange states, because they do not have a publicly traded class of common stock. Nasdaq further states that the structure of limited partnerships requires that public investors have limited rights and the general partners make all significant decisions about the operation of the limited partnership, and, as such, limited partners do not

expect to have a voice in the operations of the partnership. Registered management investment companies, the Exchange states, are already subject to a pervasive system of federal regulation in certain areas of corporate governance. Controlled companies, by definition, are companies of which more than 50% of the voting power for the election of directors are held by an individual, a group or another company, and the exemption for such companies, as stated by Nasdaq, recognizes that majority shareholders have the right to select directors and control certain key decisions, such as executive officer compensation, by virtue of their ownership rights.

Concerning foreign private issuers, Nasdaq's current rules permit any such issuer to follow its home country practice in lieu of many of Nasdaq's corporate governance listing standards, including the Exchange's compensation-related listing rules.<sup>70</sup> This allowance is granted on condition that the issuer discloses in its annual report filed with the Commission each requirement that it does not follow and describes the home country practice followed by the issuer in lieu of such requirement.<sup>71</sup> Nasdaq proposes that this allowance continue to apply generally to the Exchange's compensation committee rules as revised by the instant proposal on the same condition, namely that the issuer discloses each requirement it does not follow and describes the home country practice it follows in lieu of such requirement. However, with respect, specifically, to the enhanced standards of independence for compensation committees (concerning fees received by members and their affiliations) Nasdaq proposes that, if a listed company follows its home country practice, it must additionally disclose in its annual report filed with the Commission the reasons why it does not have an independent compensation

committee as set forth in these standards.<sup>72</sup>

#### 5. Transition to the New Rules for Companies Listed as of the Effective Date<sup>73</sup>

The proposed rule change, as amended, provides that certain of the new requirements for listed companies will be effective on July 1, 2013.<sup>74</sup> Specifically, as of that date, listed companies will be required to comply with the provisions of the proposed rule change relating to the authority of a compensation committee to retain compensation consultants, legal counsel, and other compensation advisers; the authority to fund such advisers; and the responsibility of the committee to consider independence factors before selecting such advisers.<sup>75</sup> To the extent a company does not yet have a compensation committee by that date,<sup>76</sup> these provisions will apply to the Independent Directors who determine, or recommend to the board for determination, the compensation of the CEO and all other executive officers of the company.<sup>77</sup>

<sup>72</sup> As stated by Nasdaq, this proposed condition adopts the requirements of Rule 10C-1(b)(1)(iii)(A)(4), which provides an exemption from the independence requirements of Rule 10C-1 for a "foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee."

<sup>73</sup> During the transition periods described herein, until a company is required to comply with a particular provision of the new rules, the company must continue to comply with the corresponding provision, if any, in the current rules, which are re-designated as Rule 5605A(d) and IM-5605A-6 ("Sunsetting Provisions"). See Amendment No. 1, which added this clarification as a preamble to the new Rule 5605(d). The addition mirrors a similar statement already included in the original proposal as a preamble to the Sunsetting Provisions.

<sup>74</sup> See proposed Rule 5605(d)(6), as modified by Amendment No. 1 to the proposed rule change. The original proposal provided that these provisions were to be effective immediately.

<sup>75</sup> *Id.*

<sup>76</sup> A listed company that does not currently have a compensation committee is not required to meet the requirement to have such a committee until the earlier of its first annual meeting after January 15, 2014, or October 31, 2014. See *infra* note 78 and accompanying text.

<sup>77</sup> While the provisions of the proposed rule change relating to the authority of a compensation committee to retain compensation advisers, the company's obligation to fund such advisers, and the responsibility of the committee to consider independence factors before selecting such advisers must be assigned to the committee or Independent Directors acting in lieu of a committee by July 1, 2013, the requirement that they be included in a written committee charter does not apply until a later date, as it is one of the remaining provisions of the new compensation committee rule subject to the transition period discussed below. Rule 5605(d)(6) states that companies should consider under state corporate law whether to grant the specific responsibilities and authority referenced through a charter, resolution or other board action.

<sup>66</sup> See proposed Rule 5605(d)(5). See also proposed interpretive material IM-5605-6. As noted above, listed companies other than Smaller Reporting Companies and other exempted issuers must comply with the additional independence requirements for compensation committee members set forth in proposed Nasdaq Rule 5605(d)(2)(A). See discussion in Section II.B.1., *supra*.

<sup>67</sup> See Notice.

<sup>68</sup> See Rule 5615(a)(1), (2), (4), and (5).

<sup>69</sup> See Notice. See also discussion below at note 76, *infra*, for transition periods for companies that currently use the Alternative Option and do not have compensation committees.

<sup>70</sup> See Rule 5615(a)(3). Under Nasdaq's listing rules, "foreign private issuer" has the same meaning as under Rule 3b-4 under the Exchange Act. See Rule 5005(a)(18). Nasdaq's listing rules have traditionally provided qualified exemptions for foreign private issuers so that such issuers are not required to do any act that is contrary to a law, rule or regulation of any public authority exercising jurisdiction over such issuer or that is contrary to generally accepted business practices in the issuer's country of domicile, except to the extent such exemptions would be contrary to the public securities laws. See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154, 64165 (November 12, 2003) (SR-NASD-2002-138).

<sup>71</sup> A Foreign Private Issuer that is not required to file its annual report with the Commission on Form 20-F may make this disclosure only on its Web site.

Regarding the remaining new provisions for compensation committees, the proposed rule change, as amended, provides that, in order to allow listed companies to make necessary adjustments in the course of their regular annual meeting schedule, they will have until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014,<sup>78</sup> to comply with these remaining provisions.<sup>79</sup> A listed 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).

#### 6. Phase-In Schedules: IPOs; Companies That Lose Their Exemptions; Companies Transferring From Other Markets

Nasdaq's existing rules permit a company listing in connection with its initial public offering ("IPO") to phase in its compliance with the Exchange's independence requirements for compensation and nominations committees,<sup>80</sup> as follows: Each such committee must have one independent member at the time of listing; a majority of members must be independent within 90 days of listing; and all members of such committees must be independent within one year of listing. The same phase-in schedule is permitted for companies emerging from bankruptcy<sup>81</sup> and companies ceasing to be controlled companies.<sup>82</sup> Nasdaq proposes that this schedule continue to apply and that it remain the same with respect to the new compensation committee composition requirements set forth in the proposed rule change.<sup>83</sup>

As stated by Nasdaq, this would mean that a company listing on the Exchange in connection with its IPO, a company emerging from bankruptcy, or a company ceasing to be a controlled company would be permitted to phase in its compliance with the requirements that a compensation committee have at least two members, that these members be Independent Directors as defined in Nasdaq's rules, and that they meet the enhanced standards of independence for

compensation committees (concerning fees received by members and their affiliations) adopted pursuant to Rule 10C-1.<sup>84</sup>

For a company that was, but has ceased to be, a Smaller Reporting Company, the proposed rule change, as modified by Amendment No. 1, establishes a phase-in schedule based on certain dates relating to the company's change in status.<sup>85</sup> Pursuant to Rule 12b-2 under the 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 (the "Determination Date"). A company with a public float of \$75 million or more as of the Determination Date will cease to be a Smaller Reporting Company as of the beginning of the fiscal year following the Determination Date. Under Nasdaq's proposal, the day of this change in status is the beginning of the phase-in period ("Start Date").<sup>86</sup>

By six months from the Start Date, the company will be required to comply with Rule 5605(d)(3), which sets forth the provisions described above relating to authority of a compensation committee to retain compensation advisers, the requirement that the company fund such advisers, and the requirement that the committee consider independence factors before selecting such advisers. By six months from the Start Date, the company will also be required to certify to Nasdaq (i) that 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)<sup>87</sup>; and (ii) that it has complied, or within the applicable phase-in schedule will comply, with the additional

<sup>84</sup> See Notice for an illustration provided by Nasdaq of how the compensation committee composition requirement will interact with the minimum size requirement.

<sup>85</sup> See proposed Rule 5605(d)(4), as amended. In the proposal as originally submitted, the phase-in schedule was to be the same as the phase-in schedule for a company listing in conjunction with an IPO, and was to start to run on the due date of the filing with the Commission in which the company is required to report that it is an issuer other than a Smaller Reporting Company. In Amendment No. 1, Nasdaq states that while the revised phase-in schedule is different from what it originally proposed, the amended version will allow companies sufficient time to adjust to the differences.

<sup>86</sup> See Amendment No. 1.

<sup>87</sup> See *supra* notes 26-29. This includes the provisions with which the company is now required to comply relating to authority of a compensation committee to retain compensation advisers, the requirement that the company fund such advisers, and the requirement that the committee consider independence factors before selecting such advisers.

requirements in Rule 5605(d)(2)(A) regarding compensation committee composition.

Under the proposal, as amended, a company that has ceased to be a Smaller Reporting Company will be permitted to phase in its compliance with the enhanced independence requirements for compensation committee members (relating to compensatory fees and affiliation) as follows: (i) One member must satisfy the requirements by six months from the Start Date; (ii) a majority of members must satisfy the requirements by nine months from the Start Date; and (iii) all members must satisfy the requirements by one year from the Start Date.<sup>88</sup>

However, because a Smaller Reporting Company is required to have a compensation committee and such committee is required to be comprised of at least two Independent Directors, a company that has ceased to be a Smaller Reporting Company will not be permitted to use the phase-in schedule for these requirements.

Nasdaq proposes no changes to the phase-in schedule in its current listing rules for companies transferring to Nasdaq from other markets.<sup>89</sup>

#### 7. Conforming Changes and Correction of Typographical Errors

Finally, Nasdaq proposes to make minor conforming changes to its requirements relating to audit and nominations committees and to correct certain typographical errors in its current corporate governance requirements.<sup>90</sup>

### III. Comments on the Proposed Rule Change and Nasdaq's Response

As stated previously, the Commission received a total of eight comment letters on the proposed rule change.<sup>91</sup> Three commenters expressed general support for the proposal, although one of these commenters found it wanting in some respects and another believed that it needed to be amended before being approved.<sup>92</sup> Some commenters

<sup>88</sup> During the phase-in schedule, a company that has ceased to be a Smaller Reporting Company will be required to continue to comply with the rules previously applicable to it.

<sup>89</sup> See Rule 5615(b)(3).

<sup>90</sup> See Exhibit 5 of the proposed rule change.

<sup>91</sup> See *supra* note 5.

<sup>92</sup> See ICI Letter, which urged approval of the proposal; Teamsters Letter, which strongly supported the proposal while believing that it did not fully satisfy the requirements of Rule 10C-1 and that it did not go far enough in certain respects; and Corporate Secretaries Letter, which generally supported the proposal, but believed that certain of its aspects were unnecessarily burdensome or not sufficiently clear such that the proposal needed to

<sup>78</sup> See proposed Rule 5605(d)(6), as modified by Amendment No. 1 to the proposed rule change. The original proposal had required these provisions to be implemented by the company's second annual meeting after the proposal was approved, but no later than December 31, 2014.

<sup>79</sup> The remaining provisions subject to this schedule include IM-5605-6, which is new interpretive material to be included in the text of Nasdaq's rules that elaborates on the compensation committee requirements.

<sup>80</sup> See Rule 5615(b)(1).

<sup>81</sup> See Nasdaq Listing Rule 5615(b)(2).

<sup>82</sup> See Nasdaq Listing Rule 5615(c)(3).

<sup>83</sup> Specifically, the phase-in schedule would apply to proposed Rule 5605(d)(2).

supported specific provisions of the proposal,<sup>93</sup> some opposed specific provisions,<sup>94</sup> and some sought clarification of certain aspects of the proposal.<sup>95</sup> Some commenters believed that the proposal fell short of meeting the requirements of Rule 10C-1 and believed that it should have been more stringent.<sup>96</sup> These and other comments, as well as Nasdaq's responses to some of the comments that raised issues with the proposal, are summarized below.

#### A. Compensation Committee Composition

Three commenters expressed support for Nasdaq's proposal to require all listed companies to have standing compensation committees,<sup>97</sup> and two further supported the proposal that such committees have at least two members.<sup>98</sup> Three commenters supported the provision that requires compensation committees to adopt a written charter.<sup>99</sup>

Two commenters opposed the proposal's absolute prohibition barring a compensation committee member from receiving any fees from the company.<sup>100</sup> One of these commenters argued, for example, that such a prohibition is "unnecessarily prescriptive and effectively precludes certain professionals, particularly attorneys, from compensation committee service."<sup>101</sup> In addition, this commenter argued, because most Nasdaq companies have three committees that require Independent Directors (audit, compensation, and nominations committees) and audit committee members are already subject to a "no compensatory fee" restriction, adding the same restriction for compensation committee membership would impose it "on a very high percentage of the

be amended before being approved by the Commission.

<sup>93</sup> See AFL-CIO Letter, Brown Letter, CII Letter, ICI Letter, and Teamsters Letter.

<sup>94</sup> See AFL-CIO Letter, Brown Letter, and Pinnacle Letter. See also CII Letter, which stated that it did not support certain specific aspects of the proposal.

<sup>95</sup> See Pinnacle Letter and Corporate Secretaries Letter.

<sup>96</sup> See, e.g., AFL-CIO Letter, Brown Letter, CII Letter, and Teamsters Letter.

<sup>97</sup> See AFL-CIO Letter, CII Letter, and Teamsters Letter.

<sup>98</sup> See AFL-CIO Letter, Teamsters Letter.

<sup>99</sup> See AFL-CIO Letter, CII Letter, and Teamsters Letter.

<sup>100</sup> See Pinnacle Letter and Corporate Secretaries Letter.

<sup>101</sup> Pinnacle Letter. The commenter observed that the rule would disqualify, for instance, a knowledgeable employment attorney whose firm provides only a limited amount of real estate closing or non-employment litigation services, and neither he nor his firm provided employment or compensation advice to the company. *Id.*

independent directors."<sup>102</sup> This commenter suggested that the Commission reject the proposed rule and that, if Nasdaq determined to maintain a prohibition, the prohibition should not be absolute. Rather, this commenter argued, "some level below a de minimus amount" of fees should be permitted and fees for service that have no relationship to the work of the compensation committee should be excluded.<sup>103</sup>

In a similar vein, the other commenter opposing an absolute bar believed that it is important to companies that seek to maximize the contributions of their directors not to be restricted by such a prohibition, and expressed concern that the proposal would "disproportionately impact small- and mid-cap companies, whose boards tend to be smaller and who have fewer resources to engage non-employee advisers and consultants."<sup>104</sup> This commenter believed that a better approach would be to have a company's board of directors consider such consulting or advisory fees in making its determination as to whether the member's receipt of such compensation would interfere with the member's exercise of independent judgment.<sup>105</sup>

In response, Nasdaq stated that it had carefully weighed the potential benefits of the prohibition, and had determined that the payment of direct or indirect fees from a company to a compensation committee member "could influence, or create the appearance of influencing, the member's judgment and therefore render the member unwilling or unable to provide a truly independent voice on executive compensation decisions."<sup>106</sup> Nasdaq acknowledged that the prohibition will preclude certain professionals from service on compensation committees, but stated that, "given the heightened importance of executive compensation decisions in today's business environment," it believes that "the goal of ensuring independent compensation decisions outweighs the potential negative impact of excluding a small group of individuals" from such service.<sup>107</sup>

Three commenters generally supported Nasdaq's proposal that members of compensation committees must not accept any consulting, advisory or other compensatory fees,<sup>108</sup> despite their own belief, generally, that

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> Corporate Secretaries Letter.

<sup>105</sup> *Id.*

<sup>106</sup> See Nasdaq Response Letter.

<sup>107</sup> *Id.* See also *infra* text accompanying note 143.

<sup>108</sup> See AFL-CIO Letter, CII Letter, and Teamsters Letter.

additional requirements or prohibitions should be imposed.<sup>109</sup> Two of these commenters believed, however, that the proposal falls short of the requirements of Rule 10C-1, which, in their view, requires that fees paid to a director for service on the company's board also be considered.<sup>110</sup> Another commenter argued that the language of Section 10C of the Act itself, as well as its legislative history, indicates Congress's intent that such fees be considered.<sup>111</sup> These commenters believed that compensation for board service "can, in certain circumstances, impair independence,"<sup>112</sup> because "high director fees relative to other sources of income can compromise director objectivity,"<sup>113</sup> and "highly paid directors also may be more inclined to approve large executive pay packages."<sup>114</sup> One commenter believed that the requirement of Section 10C of the Act and Rule 10C-1 to consider the source of compensation of a director goes further, and applies to all types of compensation that a director may receive, including compensation paid by any person, including non-issuers.<sup>115</sup>

In its response to comments, Nasdaq stated that companies typically adopt a uniform compensation policy that applies to all directors, not only those who serve on compensation committees, such that "a requirement to determine eligibility for compensation committee service based on director fees would lead to no meaningful distinction among directors."<sup>116</sup> In addition, Nasdaq stated, "directors should be adequately compensated to ensure that they devote appropriate time and attention to their roles and responsibilities." Nasdaq also observed that, to the extent a conflict of interest exists because directors set their own compensation, companies must disclose director compensation, and investors will become aware of excessive or non-customary director

<sup>109</sup> For a discussion of the additional kinds of rules these comments favored relating to payments made to members of compensation committees, and Nasdaq's response to their arguments, see *infra* notes 123-127 and accompanying text.

<sup>110</sup> See AFL-CIO Letter and Teamsters Letter, noting that Rule 10C-1 requires the exchanges to consider a director's "source of compensation," and arguing that this phrase includes director fees. In the proposal, Nasdaq stated that it does not believe that the intent of the Dodd-Frank Act or Rule 10C-1 was to limit independence based on director compensation. See Notice.

<sup>111</sup> See Brown Letter.

<sup>112</sup> *Id.*

<sup>113</sup> AFL-CIO Letter. See also Teamsters Letter, arguing that directors who are highly paid "may be more inclined to approve large executive pay packages."

<sup>114</sup> AFL-CIO Letter.

<sup>115</sup> See Brown Letter.

<sup>116</sup> Nasdaq Response Letter.

compensation through this means.<sup>117</sup> The Exchange further cited to the requirement in its rules that a company board make an affirmative determination that each Independent Director has no relationship that, in the opinion of the board, would interfere with his or her independent judgment in carrying out director responsibilities, and that a board could therefore consider director fees in this context.<sup>118</sup>

With respect to the other prong of Nasdaq's independence standard for compensation committee members, one commenter stated that it did not object to the Exchange's proposal to require the board of a listed company to consider whether a director is affiliated with the company or any of its subsidiaries and their affiliates in determining eligibility for compensation committee membership.<sup>119</sup> Another commenter, on the other hand, expressed disappointment that the Exchange did not propose a ban on such affiliations, maintaining that "affiliated persons—such as a large shareholder seeking a change in control of the company—may have interests or investment time horizons that differ from shareholders generally."<sup>120</sup>

In response to the latter commenter, Nasdaq stated that it had considered whether to adopt such a prohibition, but concluded that "such a blanket prohibition would be inappropriate for compensation committee members."<sup>121</sup> The Exchange believed that it may be desirable for representatives of significant stockholders in a listed company to serve on its compensation committee "since their interests are aligned with other stockholders in seeking a rational compensation program."<sup>122</sup>

Some commenters believed that the proposed rule should explicitly require the board of a listed company, when considering affiliations of a director in determining eligibility for the compensation committee, to consider personal or business relationships between the director and the company's executive officers.<sup>123</sup> As expressed by one commenter, "too many corporate directors have significant personal, financial or business ties to the senior executives that they are responsible for compensating."<sup>124</sup>

Some commenters believed that related party transactions should explicitly be included as a relevant factor in determining independence for members of compensation committees.<sup>125</sup> The additional requirements suggested by commenters also included disqualification of a director from membership on the compensation committee if an immediate family member of the director received compensation in excess of \$120,000 a year from the company even if that family member was not an executive officer of the company;<sup>126</sup> or if the director has, or in the past five years has had, a personal contract with the company, an executive officer of the company, or any affiliate of the company.<sup>127</sup>

Nasdaq responded that its definition of Independent Directors, in addition to the bright-line tests of independence that it imposes,<sup>128</sup> requires a company's board to make an affirmative determination that each such director has no relationship that, in the opinion of the board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.<sup>129</sup> "This bifurcation," Nasdaq stated, "recognizes that [Nasdaq] cannot in its rules legislate every possible relationship between a [company] and its directors and therefore empowers the board, which must be comprised of a majority of Independent Directors, to assess the relevant relationships."

Several commenters read a statement made by the Commission in adopting Rule 10C-1 as indicating that no single factor could determine a director's independence,<sup>130</sup> and believed that such a position undermines the intent of the rule.<sup>131</sup> Two commenters explicitly sought clarification from Nasdaq that a single factor can result in the loss of independence.<sup>132</sup>

In its response letter, Nasdaq confirmed that a director cannot be independent if he or she fails any of the bright-line prohibitions in the definition of Independent Director or accepts directly or indirectly any consulting, advisory, or other fee from the company

or any of its subsidiaries. The Exchange stated that its proposals "operate to exclude directors who fail these tests from serving on the compensation committee."<sup>133</sup>

Some of the above commenters expressed the belief, in general, that the definition of an independent director should be more narrowly drawn, that the bright-line tests of independence should be strengthened, and that the standards of independence should be uniform for all committees requiring Independent Directors.<sup>134</sup>

Several commenters did not support the exception proposed by Nasdaq<sup>135</sup> to allow a director who fails to meet the enhanced independence standards for compensation committees to be appointed to such a committee under exceptional and limited circumstances, provided that the director is not currently an executive officer, an employee, or the family member of an executive officer.<sup>136</sup> These commenters noted that, while providing a cure period when an independent director loses his or her independent status, Section 10C of the Act does not provide an exception to allow the appointment of a non-independent director in the first instance.<sup>137</sup> One commenter expressed the belief that the cure period provides sufficient flexibility for companies when a director ceases to be independent, such that this additional exception is not necessary.<sup>138</sup> One commenter added that the standard set by the proposed rule for permitting the exception to be used—when the appointment is in "the best interests of the Company and its Shareholders"—is "vague and ill-defined."<sup>139</sup>

Nasdaq responded that its proposal is consistent with Rule 10C-1, which permits an exchange to exempt from the enhanced independence requirements "a particular relationship with respect to members of the compensation committee, as each national securities exchange \* \* \* determines is appropriate, taking into consideration the size of an issuer and any other relevant factors."<sup>140</sup> Nasdaq noted that the exception for exceptional and limited circumstances has been included in its rules for oversight of executive compensation committees

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> See CII Letter.

<sup>120</sup> See Teamsters Letter.

<sup>121</sup> Nasdaq Response Letter.

<sup>122</sup> *Id.*

<sup>123</sup> See AFL-CIO Letter, Brown Letter, CII Letter, Teamsters Letter.

<sup>124</sup> AFL-CIO Letter. See also Teamsters Letter.

<sup>125</sup> See AFL-CIO Letter and Teamsters Letter.

<sup>126</sup> See AFL-CIO Letter and Teamsters Letter. Nasdaq's definition of Independent Director already disqualifies a director from membership on the compensation committee if an immediate family member of the director received in excess of \$120,000 from the company and also was an executive officer of the company.

<sup>127</sup> See CII Letter.

<sup>128</sup> See *supra* note 19.

<sup>129</sup> See Nasdaq Response Letter.

<sup>130</sup> See AFL-CIO Letter, Brown Letter, Teamsters Letter.

<sup>131</sup> See, e.g., Teamsters Letter.

<sup>132</sup> See AFL-CIO Letter, Brown Letter.

<sup>133</sup> Nasdaq Response Letter.

<sup>134</sup> See CII Letter, AFL-CIO Letter, Teamsters Letter.

<sup>135</sup> See *supra* note 47.

<sup>136</sup> See AFL-CIO Letter, Brown Letter, CII Letter.

<sup>137</sup> See, e.g., CII Letter.

<sup>138</sup> See AFL-CIO Letter.

<sup>139</sup> Brown Letter.

<sup>140</sup> Rule 10C-1(b)(1)(iii)(B).

since they were implemented.<sup>141</sup> The Exchange stated that the exception has been used throughout its life—albeit infrequently—and that the Exchange therefore believes that it adds value to its rules.<sup>142</sup> The Exchange added that it believed that it is appropriate to allow a listed company the flexibility afforded by the provision and that it is particularly important for a smaller company “that may have relationships that require such flexibility,” and that, in this way, the exception also addresses concerns raised by some commenters that the proposal to prohibit a compensation committee member from accepting directly or indirectly any consulting, advisory or other compensatory fee from the company is overly prescriptive.<sup>143</sup>

#### B. Compensation Adviser Independence Factors

The Commission received letters from three commenters relating to the provision of the proposed rule change that requires a compensation committee to take into consideration the factors set forth in the proposal in the selection of a compensation consultant, legal counsel, or other adviser to the committee.<sup>144</sup>

One commenter believed that Nasdaq’s proposed rule could be read as requiring a compensation committee to consider the independence factors set forth in Rule 10C–1 only when selecting independent counsel, rather than any outside legal counsel that might provide legal advice to a compensation committee.<sup>145</sup> The commenter sought an explicit statement from Nasdaq that a compensation committee is not required to consider the enumerated independence factors with respect to any outside legal counsel, “other than in circumstances where the compensation committee has determined it is advisable to retain independent legal counsel, such as in the case of an investigation or litigation.”<sup>146</sup> Otherwise, the commenter believed, the proposed rule “may cause an unnecessary expenditure of resources by companies that feel compelled to

conduct an independent analysis of all counsel providing advice to the Committee.”<sup>147</sup>

In its response letter, Nasdaq disagreed with this commenter’s reading of Rule 10C–1, stating that, while a compensation committee is not required to retain an independent compensation adviser, the compensation committee is required to conduct the independence analysis set forth in Rule 10C–1 before selecting any compensation adviser other than in-house legal counsel.<sup>148</sup>

A second commenter believed that at least one additional factor should be considered: “whether the compensation committee consultants, legal counsel, or other advisers require that their clients contractually agree to indemnify or limit their liability.”<sup>149</sup> The commenter believed that such contractual provisions “raise conflict of interest red flags” that every compensation committee should consider in determining the independence of the consultant.<sup>150</sup>

Another commenter, while generally supporting the Nasdaq proposal, maintained that the required independence assessment will be “time-consuming and burdensome” due to the scope of information that will need to be gathered in order to conduct the required independence assessment.<sup>151</sup> This commenter believed that uncertainty over the scope of the requirement could have a counterproductive effect of discouraging compensation committees from obtaining the advice of advisers subject to the rule, particularly in situations where quick action is required of the compensation committee, and further identified a number of specific issues that it believed the Exchange should address to provide greater clarity regarding the standard.<sup>152</sup>

#### C. Opportunity to Cure Defects

One commenter supported the rule proposed by the Exchange to permit issuers a period of time, under specified conditions, to cure failures to comply with the independence requirements for compensation committee members.<sup>153</sup> The commenter was concerned, however, that the proposed rules did not specify a cure period for any other form of non-compliance with the new

rules.<sup>154</sup> The commenter believed that a company should be allowed to take corrective action within a reasonable time after the company’s senior executives learn of the non-compliance.

#### D. Exemptions

The Commission received one comment letter supporting the Exchange’s proposal to exempt investment companies from the Rule 10C–1 requirements.<sup>155</sup> As the commenter noted, although Rule 10C–1 exempts certain entities, including registered open-end management investment companies, from the enhanced independence requirements for members of compensation committees, it did not explicitly exempt other types of registered management investment companies, including closed-end funds, from any of the requirements of Rule 10C–1. Under the Nasdaq proposal, both closed-end and open-end funds would be exempt from all the requirements of the rule.

The commenter supported this aspect of the proposal, stating that both open-end and closed-end funds typically are externally managed and do not employ executives or by their nature have employees. The commenter believed that such funds are adequately governed by other federal regulation with respect to corporate governance matters, generally, and compensation matters, specifically.<sup>156</sup>

#### E. Transition Period

One commenter voiced support for the transition period proposed by Nasdaq for compliance with the new compensation committee independence standard, but believed that the Exchange should provide a longer period for companies to satisfy proposed Rule 5605(d)(3), relating to the authority of a compensation committee to retain compensation consultants, legal counsel, and other compensation advisers; the authority to fund such advisers; and the responsibility of the

<sup>141</sup> Nasdaq Response Letter. In response to the concern that a board could use a non-independent director indefinitely, Nasdaq noted that it tracks the use of the exception and can exercise its discretionary authority to apply additional or more stringent criteria for the initial or continued listing of particular securities and deny use of the exception to any company that the Exchange believes is abusing it. *See id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *See* Wilson Sonsini Letter, CII Letter, and Corporate Secretaries Letter.

<sup>145</sup> *See* Wilson Sonsini Letter.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *See* Nasdaq Response Letter.

<sup>149</sup> CII Letter.

<sup>150</sup> *Id.*

<sup>151</sup> Corporate Secretaries Letter.

<sup>152</sup> The Commission notes that Nasdaq addressed some of the commenter’s concerns in Amendment No. 2.

<sup>153</sup> *See* Corporate Secretaries Letter.

<sup>154</sup> *See id.* The commenter mentioned, in particular, the requirement that the committee may obtain advice from a consultant or adviser only after assessing that individual’s independence. The commenter believed that inadvertent violations of this requirement could arise, for example, if a person is appearing before a compensation committee solely to provide information or other services, and the individual then on a solicited or unsolicited basis makes a statement that could be viewed as providing advice on executive compensation. In the absence of a cure mechanism, the commenter believed, the company would be in violation of the listing standard and have no recourse.

<sup>155</sup> *See* ICI Letter.

<sup>156</sup> *Id.*

committee to consider independence factors before selecting such advisers.<sup>157</sup>

#### IV. Discussion

After careful review, the Commission finds that the Nasdaq proposal, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>158</sup> In particular, the Commission finds that the amended proposed rule change is consistent with the requirements of Section 6(b) of the Act,<sup>159</sup> as well as with Section 10C of the Act<sup>160</sup> and Rule 10C-1 thereunder.<sup>161</sup> Specifically, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,<sup>162</sup> which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and not be designed to permit, among other things, unfair discrimination between issuers.

The development and enforcement of meaningful listing standards for a national securities exchange is of substantial importance to financial markets and the investing public. Meaningful listing standards are especially important given investor expectations regarding the nature of companies that have achieved an exchange listing for their securities. The corporate governance standards embodied in the listing rules of national securities exchanges, in particular, play an important role in assuring that companies listed for trading on the exchanges' markets observe good governance practices, including a reasoned, fair, and impartial approach for determining the compensation of corporate executives. The Commission believes that the Nasdaq proposal will foster greater transparency, accountability, and objectivity in the oversight of compensation practices of

listed issuers and in the decision-making processes of their compensation committees.

In enacting Section 10C of the Act as one of the reforms of the Dodd-Frank Act,<sup>163</sup> Congress resolved to require that "board committees that set compensation policy will consist only of directors who are independent."<sup>164</sup> In June 2012, as required by this legislation, the Commission adopted Rule 10C-1 under the Act, which directs the national securities exchanges to prohibit, by rule, the initial or continued listing of any equity security of an issuer (with certain exceptions) that is not in compliance with the rule's requirements regarding issuer compensation committees and compensation advisers.

In response, Nasdaq submitted the proposed rule change, which includes rules intended to comply with the requirements of Rule 10C-1 and additional provisions designed to strengthen the Exchange's listing standards relating to compensation committees. The Commission believes that the proposed rule change satisfies the mandate of Rule 10C-1 and otherwise will promote effective oversight of its listed issuers' executive compensation practices.

The Commission notes that a number of the commenters generally supported the proposed rule change, although some commenters offered suggestions to clarify or improve various provisions of Nasdaq's proposal. The Commission believes that the proposed rule change, as modified by Amendment Nos. 1 and 2, appropriately revises Nasdaq's rules for compensation committees of listed companies, for the following reasons:

##### A. Compensation Committee Composition and Charter

The Commission believes that it is reasonable for Nasdaq to require each company listed on its market to have a compensation committee. Although the Alternative Option to a formal committee in the Exchange's current rules may have been useful to a small number of companies,<sup>165</sup> the Commission agrees that the heightened importance of compensation decisions and oversight of executive compensation in today's environment,

as well as the benefits that can result for investors of having a standing committee overseeing compensation matters, makes it appropriate and consistent with investor protection and the public interest under Section 6(b)(5) of the Act for Nasdaq to raise its standards in this regard. In making this determination the Commission is aware that Rule 10C-1 does not require listed companies of national securities exchanges to have a committee dedicated to compensation matters. Nevertheless, it is consistent with Section 6(b)(5) of the Act for Nasdaq to require all its listed companies to have an independent compensation committee overseeing executive compensation matters because of the importance and accountability to investors that such a formal structure can provide.<sup>166</sup> The Commission also notes that some of the other requirements of Rule 10C-1 apply only when a company has a committee overseeing compensation matters.<sup>167</sup> Thus, the requirement to have a compensation committee will trigger the additional protections for shareholders created by these requirements.

Similarly, the Commission believes that it is appropriate for Nasdaq to raise its standards to require the compensation committee of each issuer to have at least two members, instead of permitting a sole individual to be responsible for compensation policy, and that this furthers investor protection and the public interest in accordance with Section 6(b)(5). In light of the importance of compensation matters, the added thought and objectivity that is likely to result when two or more individuals deliberate over how much a listed company should pay its executives, and what form such compensation should take, is consistent with the goal of promoting more accountability to shareholders on executive compensation matters. Moreover, given the complexity of executive compensation packages for corporate executives, it is reasonable for Nasdaq to require listed companies to have the input of more than one committee member on such matters. Finally, we note that, as Nasdaq stated in its filing, only a small number of

<sup>157</sup> See Corporate Secretaries Letter. The Commission notes that the commenter's letter was submitted prior to Nasdaq's submission of Amendment No. 1, in which the Exchange revised the proposed transition period for compliance with Rule 5605(d)(3).

<sup>158</sup> In approving the Nasdaq proposed rule change, as amended, the Commission has considered its impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>159</sup> 15 U.S.C. 78f(b).

<sup>160</sup> 15 U.S.C. 78j-3.

<sup>161</sup> 17 CFR 240.10C-1.

<sup>162</sup> 15 U.S.C. 78f(b)(5).

<sup>163</sup> See *supra* note 9.

<sup>164</sup> See H.R. Rep. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title IX, Subtitle E "Accountability and Executive Compensation," at 872-873 (Conf. Rep.) (June 29, 2010).

<sup>165</sup> As stated by Nasdaq, as of June 30, 2012, only 25 of its 2,636 listed companies relied on the Alternative Option in lieu of having a standing compensation committee. See Notice.

<sup>166</sup> See, e.g., Section 303A.05 of the New York Stock Exchange ("NYSE") Listed Company Manual, which does not provide for an Alternative Option as is currently allowed under Nasdaq rules.

<sup>167</sup> Under Rule 10C-1, the provisions of Rule 10C-1(b)(2)(i) (concerning the authority to retain or obtain the advice of a compensation adviser) and Rule 10C-1(b)(3) (concerning funding for compensation advisers) do not apply to members of the board of directors who oversee executive compensation matters on behalf of the board of directors outside a committee structure.

currently listed companies have a compensation committee of only one member. The Commission believes that, with the transition period proposed by Nasdaq for such companies to add an additional member, the two-member requirement will not be an onerous burden for such companies and should actually strengthen their review of compensation matters.

The proposal by the Exchange to require a compensation committee to have a written charter detailing the committee's authority and responsibility is also consistent with Section 6(b)(5) of the Act and will help listed companies to comply with the rules being adopted by Nasdaq to fulfill its mandate under Rule 10C-1. For example, as noted above, under Nasdaq's proposal the charter must set forth the compensation committee's responsibilities as well as the specific authority concerning compensation advisers as required under Rule 10C-1.<sup>168</sup> A written charter will also provide added transparency for shareholders regarding how a company determines compensation and may clarify and improve the process itself. In this regard, the Commission notes that Nasdaq's requirement that listed companies review and reassess the adequacy of the compensation's committee charter on an annual basis will also help to ensure accountability and transparency on an on-going basis. The Commission also notes that several exchanges already require their compensation committees to have written charters.<sup>169</sup>

As discussed above, under Rule 10C-1 the exchanges must adopt listing standards that require each member of a compensation committee to be independent, and to develop a definition of independence after considering, among other relevant factors, the source of compensation of a director, including any consulting, advisory or other compensatory fee paid by the issuer to the director as well as whether the director is affiliated with the issuer or any of its subsidiaries or their affiliates.

The Commission notes, however, that Rule 10C-1 leaves it to each exchange to formulate a final definition of independence for these purposes, subject to review and final Commission

approval pursuant to Section 19(b) of the Act. As the Commission stated in the Rule 10C-1 Adopting Release, "given the wide variety of issuers that are listed on exchanges, we believe that the exchanges should be provided with flexibility to develop independence requirements appropriate for the issuers listed on each exchange and consistent with the requirements of the independence standards set forth in Rule 10C-1(b)(1)."<sup>170</sup> This discretion comports with the Act, which gives the exchanges the authority, as self-regulatory organizations, to propose the standards they wish to set for companies that seek to be listed on their markets, consistent with the Act and the rules and regulations thereunder, and, in particular, Section 6(b)(5) of the Act.

As noted above, in addition to retaining its existing independence standards that currently apply to board and compensation committee members, which include certain bright-line tests, Nasdaq has determined to adopt a definition that prohibits a director who receives compensation or fees from a listed company (other than, among other things, director compensation) from serving on the company's compensation committee.<sup>171</sup>

As the Exchange noted in its proposal, under the bright-line tests of its general rules for director independence, directors can still be considered independent and serve on listed companies' compensation committees if they receive fees that do not exceed certain thresholds.<sup>172</sup> This is in contrast to Nasdaq's requirements to serve on a listed company's audit committee, which bar a director who receives any compensatory fees from the company. In considering the Fees Factor under Rule 10C-1, Nasdaq stated that it did not see any compelling justification to set a different standard with respect to the acceptance of compensatory fees for members of the compensation committee than for members of audit committees.

The Commission notes that, while two commenters opposed Nasdaq's proposed outright bar on the receipt of these fees,<sup>173</sup> other commenters believed that the Exchange's proposal relating to compensatory fees fell short

of Rule 10C-1's requirements<sup>174</sup> or otherwise proposed additional requirements.<sup>175</sup> In response to the commenters opposing the fee prohibition, the Exchange stated that it carefully weighed the benefits and burdens of its proposal and concluded that a director's receipt of compensatory fees from a company (other than compensation for board and board committee service or compensation under a retirement plan for prior service with the company as described above<sup>176</sup>) could render the member unwilling or unable to provide a truly independent voice on executive compensation decisions.<sup>177</sup> The Exchange further stated that, although certain individuals may be excluded from the compensation committee because of the proposal's fee restriction, the restriction was warranted given the heightened importance of executive compensation decisions in today's business environment.

The Commission believes that the Exchange has complied with Rule 10C-1 and Section 10C and that the proposed compensatory fee restriction, which is designed to protect investors and the public interest, is consistent with the requirements of Section 6(b)(5) of the Act. The Commission notes that the compensatory fee restriction will help to ensure that compensation committee members cannot receive directly or indirectly fees that could potentially influence their decisions on compensation matters.

The Commission recognizes that some commenters did not believe that the Nasdaq proposal went far enough because the Exchange did not adequately consider the compensation that directors receive for board or committee service in formulating its standards of independence for service on the compensation committee, and, in particular, the levels to which such compensation may rise.<sup>178</sup> The Commission notes, however, that, as Nasdaq stated, to the extent a conflict of interest exists because directors set their

<sup>174</sup> See AFL-CIO Letter, Brown Letter, and Teamsters Letter, maintaining that Nasdaq's proposal "falls short" of the Rule 10C-1 provision requiring exchanges to consider a director's source of compensation. See also *supra* notes 123-127 and accompanying text.

<sup>175</sup> See, e.g., CII Letter ("the Council's policies on independence relating to the acceptance of compensatory fees are clearly more narrowly drawn than those of [Nasdaq's proposal]").

<sup>176</sup> See *supra* notes 35-36 and accompanying text.

<sup>177</sup> See Nasdaq Response Letter, *supra* note 6.

<sup>178</sup> As stated by commenters, "[h]igh director fees relative to other sources of income can compromise director objectivity" and "[h]ighly paid directors also may be more inclined to approve large executive pay packages." AFL-CIO Letter. See also Teamsters Letter.

<sup>168</sup> The Commission notes that the provision that is required in the charter regarding the authority of the committee to retain compensation advisers, the requirement that the company fund such advisers, and the requirement that the committee consider independence factors before selecting such advisers does not apply under the Nasdaq proposal to Smaller Reporting Companies. See *supra* notes 62-65 and accompanying text.

<sup>169</sup> See, e.g., NYSE Listed Company Manual, Section 303A.05.

<sup>170</sup> As explained further in the Rule 10C-1 Adopting Release, prior to final approval, the Commission will consider whether the exchanges' proposed rule changes are consistent with the requirements of Section 6(b) and Section 10C of the Exchange Act.

<sup>171</sup> See *supra* note 33-36 and accompanying text.

<sup>172</sup> See Nasdaq Listing Rules 5605(a)(2)(B) and (D).

<sup>173</sup> See Corporate Secretaries Letter and Pinnacle Letter and *supra* notes 100-105 and accompanying text.

own compensation, companies must disclose director compensation, and investors will become aware of excessive or non-customary director compensation through this means.<sup>179</sup> In addition, a company board must make an affirmative determination that each Independent Director has no relationship that, in the opinion of the board, would interfere with his or her independent judgment in carrying out director responsibilities, and a board could therefore consider director compensation in that context. The Commission believes that these arguments are sufficient to find that Nasdaq has complied with the requirements of Rule 10C-1 in this regard.

With respect to the Affiliation Factor of Rule 10C-1, Nasdaq has concluded that an outright bar from service on a company's compensation committee of any director with an affiliation with the company, its subsidiaries, and their affiliates is inappropriate for compensation committees. Nasdaq's existing independence standards will also continue to apply to those directors serving on the compensation committee. Nasdaq maintains that it may be appropriate for certain affiliates, such as representatives of significant stockholders, to serve on compensation committees "since their interests are likely aligned with those of other stockholders in seeking an appropriate executive compensation program." In spite of the argument of one commenter in favor of an outright ban on affiliations with the company,<sup>180</sup> the Commission believes that Nasdaq's approach of requiring boards only to consider such affiliations is reasonable and consistent with the requirements of the Act.

The Commission notes that Congress, in requiring the Commission to direct the exchanges to consider the Affiliation Factor, did not declare that an absolute bar was necessary. Moreover, as the Commission stated in the Rule 10C-1 Adopting Release, "In establishing their independence requirements, the exchanges may determine that, even though affiliated directors are not allowed to serve on audit committees, such a blanket prohibition would be inappropriate for compensation committees, and certain affiliates, such as representatives of significant shareholders, should be permitted to serve."<sup>181</sup> In determining that Nasdaq's

affiliation standard is consistent with Sections 6(b)(5) and 10C under the Act, the Commission notes that Nasdaq's proposal requires a company's board, in selecting compensation committee members, to consider whether any such affiliation would impair a director's judgment as a member of the compensation committee. We believe that this should give companies the flexibility to assess whether a director who is an affiliate, including a significant shareholder, should or should not serve on the company's compensation committee, depending on the director's particular affiliations with the company.

As to consideration by Nasdaq of whether it should adopt any additional relevant independence factors, the Exchange stated that it reviewed its rules in the light of Rule 10C-1, but concluded that its existing rules together with its proposed rules are sufficient to ensure committee member independence. The Commission believes that, through this review, the Exchange has complied with the requirement that it consider relevant factors, including, but not limited to, the Fees and Affiliation Factors in determining its definition of independence for compensation committee members. The Commission does not agree with the commenters who argued that the Exchange's proposal falls short of the requirements and/or intent of Section 10C of the Act and Rule 10C-1.<sup>182</sup> The Commission notes that Rule 10C-1 requires each exchange to consider relevant factors in determining independence requirements for members of a compensation committee, but does not require the final definition and the rules imposed on listed companies to reflect any such additional factors.

As noted above, several commenters argued that Nasdaq should require other ties between directors and the company, including business and personal relationships with executives of the company, to be considered by boards in making independence determinations.<sup>183</sup> The Commission did emphasize in the Rule 10C-1 Adopting Release that "it is important for

shareholders' interests not being aligned with those of other shareholders and that the exchanges may want to consider these other ties between a listed issuer and a director. While the Exchange did not adopt any additional factors, the current affiliation standard would still allow a company to prohibit a director whose affiliations "impair the director's judgment" as a member of the committee. See also *infra* notes 183-184.

<sup>182</sup> See *supra* notes 110-111 and accompanying text.

<sup>183</sup> See *supra* notes 123-124 and accompanying text.

exchanges to consider other ties between a listed issuer and a director \* \* \* that might impair the director's judgment as a member of the compensation committee,"<sup>184</sup> and noted that "the exchanges might conclude that personal or business relationships between members of the compensation committee and the listed issuer's executive officers should be addressed in the definition of independence." However, the Commission did not require exchanges to reach this conclusion and thus Nasdaq's decision that such ties need not be included explicitly in its definition of independence does not render its proposal insufficient.

In explaining why it did not include, specifically, personal and business relationships as a factor, Nasdaq cites its standards for Independent Directors, generally, which require the board of directors of a listed issuer to make an affirmative determination that each such director has no relationship that, in the opinion of the board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.<sup>185</sup> All compensation committee members must meet the general independence standards under Nasdaq's rules in addition to the two new criteria being adopted herein. The Commission therefore expects that boards, in fulfilling their obligations, will apply this standard to each such director's individual responsibilities as a board member, including specific committee memberships such as the compensation committee. Although personal and business relationships, related party transactions, and other matters suggested by commenters are not specified either as bright-line disqualifications or explicit factors that must be considered in evaluating a director's independence, the Commission believes that compliance with Nasdaq's rules and the provision noted above would demand consideration of such factors with respect to compensation committee members, as well as to all Independent Directors on the board.

The Commission does not believe that Nasdaq is required in the current proposed rule change to consider further revisions of its independence rules as suggested by some commenters,<sup>186</sup> although it may wish to do so in the future. Finally, notwithstanding the concern of some

<sup>184</sup> *Id.*

<sup>185</sup> See Nasdaq Rule 5605(a)(2).

<sup>186</sup> See *supra* note 134 and accompanying text.

<sup>179</sup> See Nasdaq Response Letter.

<sup>180</sup> See Teamsters Letter and *supra* note 120 and accompanying text.

<sup>181</sup> Rule 10C-1 Adopting Release. At the same time, the Commission noted that significant shareholders may have other relationships with the listed company that would result in such

commenters,<sup>187</sup> the Commission confirms that Rule 10C-1 does not mean that a director cannot be disqualified on the basis of one factor alone. Although Nasdaq does not state this explicitly, the Commission believes that nothing in Rule 10C-1 or in Nasdaq's current or proposed rules implies otherwise.

Nasdaq proposes that the "Exceptional and Limited Circumstances" provision in its current rules, which allows one director who fails to meet the Exchange's Independent Director definition to serve on a compensation committee under certain conditions, apply to the enhanced independence standards discussed above that the Exchange is adopting to comply with Rule 10C-1. The Commission believes that the discretion granted to each exchange by Rule 10C-1, generally, to determine the independence standards it adopts to comply with the Rule includes the leeway to carve out exceptions to those standards, as long as they are consistent with the Act. Nasdaq also cites, in justifying the exception, the provision of Rule 10C-1 that permits an exchange to exempt a particular relationship with respect to members of the compensation committee as the exchange determines is appropriate, taking into consideration the size of an issuer and any other relevant factors. In this respect, Nasdaq states that the exception, although infrequently used, has been valuable, and states that the flexibility afforded by the exception is particularly important for a smaller company.

Regarding the justification for such an exception, the Commission notes that it long ago approved as consistent with the Act the same exception and concept in the context of Nasdaq's definition of Independent Director under Exchange Rule 5605(a)(2),<sup>188</sup> with respect to compensation committees, as well as for nominations committees and audit committees. Although the additional independence standards required by Rule 10A-3 for audit committees are not subject to this exception, the Commission notes that Rule 10C-1 grants exchanges more discretion than Rule 10A-3 when considering independence standards for compensation committee membership. One commenter was also concerned that the board could include a non-independent director indefinitely on its compensation committee by using the exception.<sup>189</sup> The Commission notes that a member appointed under the

Exceptional and Limited Circumstances provision may not serve longer than two years. Further, in the Nasdaq Response Letter, the Exchange stated that it tracks the use of the exception by listed companies and would have discretion in its rules to deny the use of the exception if it thought a company was abusing it.<sup>190</sup>

#### *B. Authority of Committees to Retain Compensation Advisers; Funding; and Independence of Compensation Advisers and Factors*

As discussed above, Nasdaq proposes to set forth explicitly in its rules the requirements of Rule 10C-1 regarding a compensation committee's authority to retain compensation advisers, its responsibilities with respect to such advisers, and the listed company's obligation to provide appropriate funding for payment of reasonable compensation to a compensation adviser retained by the committee.<sup>191</sup> As such, the Commission believes these provisions meet the mandate of Rule 10C-1 and are consistent with the Act.

As discussed above, the proposed rule change requires the compensation committee of a listed company to consider the six factors relating to independence that are enumerated in the proposal before selecting a compensation consultant, legal counsel or other adviser to the compensation committee. The Commission believes that this provision is consistent with Rule 10C-1 and Section 6(b)(5) of the Act.

As noted above, one commenter believed that Rule 10C-1 could be read as not requiring a compensation committee to consider the enumerated independence factors with respect to regular outside legal counsel and sought confirmation of this reading from Nasdaq.<sup>192</sup> This reading is incorrect and Nasdaq has amended its rule language to clarify this issue. The Commission notes that Rule 10C-1 includes an instruction that specifically requires a compensation committee to conduct the independence assessment with respect to "any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house counsel."<sup>193</sup> To avoid any confusion, Nasdaq, in Amendment No. 1, added rule text that

<sup>190</sup> See *supra* note 141.

<sup>191</sup> The Commission notes that, in Amendment No. 1, Nasdaq revised its proposed rule text to set forth these requirements in full.

<sup>192</sup> See *supra* notes 145-146 and accompanying text.

<sup>193</sup> See Instruction to paragraph (b)(4) of Rule 10C-1.

reflects this instruction in its own rules.<sup>194</sup>

In approving this aspect of the proposal, the Commission notes that compliance with the rule requires an independence assessment of any compensation consultant, legal counsel, or other adviser that provides advice to the compensation committee, and is not limited to advice concerning executive compensation. However, Nasdaq has proposed, in Amendment No. 2, to add language to the provision regarding the independence assessment of compensation advisers<sup>195</sup> to state that 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. Nasdaq states that this exception is based on Item 407(e)(3)(iii) of Regulation S-K, which provides a limited exception to the Commission's requirement for a registrant to disclose any role of compensation consultants in determining or recommending the amount and form of a registrant's executive and director compensation.<sup>196</sup>

The Commission views Nasdaq's proposed exception as reasonable, as the Commission determined, when adopting the compensation consultant disclosure requirements in Item 407(e)(3)(iii), that the two excepted categories of advice do not raise conflict of interest concerns.<sup>197</sup> The Commission also made similar findings when it noted it was continuing such exceptions in the Rule 10C-1 Adopting Release, including excepting such roles from the new conflict of interest disclosure rule required to implement Section

<sup>194</sup> See *supra* note 54 and accompanying text.

<sup>195</sup> See proposed Rule 5605(d)(3), as amended by Amendment No. 2.

<sup>196</sup> See 17 CFR 229.407(e)(3)(iii).

<sup>197</sup> See Proxy Disclosure Enhancements, Securities Act Release No. 9089 (Dec. 19, 2009), 74 FR 68334 (Dec. 23, 2009), at 68348 ("We are persuaded by commenters who noted that surveys that provide general information regarding the form and amount of compensation typically paid to executive officers and directors within a particular industry generally do not raise the potential conflicts of interest that the amendments are intended to address.").

<sup>187</sup> See *supra* notes 130-132 and accompanying text.

<sup>188</sup> See *supra* note 19.

<sup>189</sup> See Brown Letter.

10C(c)(2). The Commission also believes that the exception should allay some of the concerns raised by the commenters regarding the scope of the independence assessment requirement. Based on the above, the Commission believes these limited exceptions are consistent with the investor protection provisions of Section 6(b)(5) of the Act.

Regarding the belief of another commenter that the independence assessment requirement could discourage compensation committees from obtaining the advice of advisers,<sup>198</sup> the Commission notes that, as already discussed, nothing in the proposed rule prevents a compensation committee from selecting any adviser that it prefers, including ones that are not independent, after considering the six factors. In this regard, in Amendment No. 1 Nasdaq added specific rule language stating, among other things, that nothing in its rule requires a compensation adviser to be independent, only that the compensation committee must consider the six independence factors before selecting or receiving advice from a compensation adviser.<sup>199</sup>

Regarding the commenter's concern over the burdens that the Exchange proposal imposes,<sup>200</sup> the Commission notes that Rule 10C-1 explicitly requires exchanges to require consideration of these six factors.<sup>201</sup> Moreover, five of the six factors were dictated by Congress itself in the Dodd-Frank Act. As previously stated by the Commission in adopting Rule 10C-1, the requirement that compensation committees consider the independence of potential compensation advisers before they are selected should help assure that compensation committees of affected listed companies are better informed about potential conflicts, which could reduce the likelihood that they are unknowingly influenced by conflicted compensation advisers.<sup>202</sup> The changes to Nasdaq's rules on compensation advisers should therefore benefit investors in Nasdaq listed companies and are consistent with the

requirements in Section 6(b)(5) of the Act that rules of the exchange further investor protection and the public interest.

Finally, one commenter requested guidance "on how often the required independence assessment should occur."<sup>203</sup> This commenter observed that it "will be extremely burdensome and disruptive if prior to each such [compensation committee] meeting, the committee had to conduct a new assessment." The Commission anticipates that compensation committees will conduct such an independence assessment at least annually.

#### C. Application to Smaller Reporting Companies

The Commission believes that the requirement for Smaller Reporting Companies, like all other listed companies, to have a compensation committee, composed solely of Independent Directors, with at least two members is reasonable and consistent with the protection of investors. The Commission notes that Nasdaq's rules for compensation committees have not made a distinction for Smaller Reporting Companies in the past. However, consistent with the exemption of Smaller Reporting Companies from Rule 10C-1, the Exchange has decided not to require Smaller Reporting Companies to meet its proposed new independence requirements as to compensatory fees and affiliation as well as the requirements concerning compensation advisers.

Nasdaq will also require a Smaller Reporting Company to adopt a formal written compensation committee charter or board resolution that specifies the compensation committee's responsibilities and authority, but the company will not be required to review and reassess the adequacy of the charter or board resolution on an annual basis. This is different from other Nasdaq listed companies, which must include the committee's responsibilities and authority specifically in a formal written charter and must review the charter's adequacy on an annual basis.

The Commission believes that these provisions are consistent with the Act and do not unfairly discriminate between issuers. The Commission believes that, for similar reasons to those for which Smaller Reporting Companies are exempted from the Rule 10C-1 requirements, it makes sense for Nasdaq to provide some flexibility to Smaller Reporting Companies regarding whether the compensation committee's

responsibilities should be set forth in a formal charter or through board resolution. Further, because a Smaller Reporting Company does not need to include in its charter or board resolution the additional provisions regarding compensation advisers that Nasdaq is requiring all other listed companies to include to comply with Rule 10C-1,<sup>204</sup> and in view of the potential additional costs of an annual review, it is reasonable not to require a Smaller Reporting Company to conduct an annual assessment of its charter or board resolution.

#### D. Opportunity To Cure Defects

Rule 10C-1 requires the rules of an exchange to provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for the exchange, under Rule 10C-1, to prohibit the issuer's listing. Rule 10C-1 also specifies that, with respect to the independence standards adopted in accordance with the requirements of the Rule, an exchange may provide a cure period 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.

The Commission notes that the cure period that Nasdaq proposes for companies that fail to comply with the enhanced independence requirements designed to comply with Rule 10C-1 is not exactly the same as the cure period that the Rule sets forth as an option.<sup>205</sup> The Nasdaq proposal adds the proviso that, if the annual shareholders meeting occurs no later than 180 days following the event that caused the noncompliance, the company instead has 180 days from the event to regain compliance.

The Commission believes that, although the cure period proposed by Nasdaq gives a company more leeway in certain circumstances than the cure period suggested under Rule 10C-1, the accommodation is fair and reasonable. As a general matter, it allows all companies at least 180 days to cure noncompliance. To give a specific example, the proposal would afford a company additional time to comply,

<sup>198</sup> See Corporate Secretaries Letter and *supra* note 151 and accompanying text.

<sup>199</sup> See *supra* notes 56-58 and accompanying text.

<sup>200</sup> See *supra* note 151 and accompanying text.

<sup>201</sup> The Commission also does not agree with the argument of one commenter that Nasdaq must require compensation committees to specifically consider, among the independence factors relating to compensation advisers, whether such an adviser requires that clients contractually agree to indemnify or limit their liability. See CII Letter. The Commission views as reasonable the Exchange's belief that the six factors set forth in Rule 10C-1 are sufficient for the required independence assessment.

<sup>202</sup> See Rule 10C-1 Adopting Release, *supra* note 11.

<sup>203</sup> See Corporate Secretaries Letter.

<sup>204</sup> As discussed *supra* notes 64-65 and accompanying text, the charter or board resolution of a Smaller Reporting Company will not be required to include, like the charters of other listed companies, a grant of authority to the committee to retain compensation advisers, a requirement that the company fund such advisers, and a requirement that the committee consider independence factors before selecting such advisers, because Smaller Reporting Companies are not subject to these requirements.

<sup>205</sup> See *supra* notes 42-44 and accompanying text.

than the Rule 10C-1 option, where a member of the compensation committee ceases to be independent two weeks before the company's next annual meeting. The Commission further notes that it has approved a similar cure period in the context of other Nasdaq corporate governance requirements.<sup>206</sup>

The Commission agrees with the understanding of the commenter who believed that Rule 10C-1 requires that an exchange provide a company an opportunity to cure any defects in compliance with any of the new requirements.<sup>207</sup> The Commission believes that Nasdaq's general due process procedures for the delisting of companies that are out of compliance with the Exchange's rules satisfy this requirement.<sup>208</sup> In particular, Nasdaq's rules provide that, unless continued listing of the company raises a public interest concern, when a company is deficient in compliance with, among other rules, Rule 5605, which includes the Exchange's standards for compensation committees, the listed company may submit a plan for compliance. The rules permit the Exchange's staff to extend the deadline for regaining compliance, under established parameters, and, if the company does not regain compliance within the time period provided by all applicable staff extensions—at which point the staff will immediately issue a determination indicating the date on which the company's securities will be suspended—a company can still request review by a hearings panel.

The Commission believes that these general procedures for companies out of compliance with listing requirements, in addition to the particular cure provisions for failing to meet the new independence standards, adequately meet the mandate of Rule 10C-1 and also are consistent with investor protection and the public interest since they give a company a reasonable time period to cure non-compliance with these important requirements before they will be delisted.

#### E. Exemptions

As discussed above, asset-backed issuers and other passive issuers, cooperatives, limited partnerships, registered management investment companies, and controlled companies are exempt from Nasdaq's existing rules

relating to compensation, and Nasdaq proposes to extend the exemptions for these entities to the new requirements of the proposed rule change. The Commission notes that Rule 10C-1 allows exchanges to exempt from the listing rules adopted pursuant to Rule 10C-1 certain categories of issuers, as the national securities exchange determines is appropriate.<sup>209</sup> The Commission believes that, given the specific characteristics of the aforementioned types of issuers,<sup>210</sup> it is reasonable and consistent with Section 6(b)(5) of the Act for the Exchange to exempt them from the new requirements.

Specifically with regard to investment companies, the Commission received one comment letter supporting the Exchange's proposal to exempt such companies from the Rule 10C-1 requirements.<sup>211</sup> As the commenter noted, although Rule 10C-1 exempts certain entities, including registered open-end management investment companies, from the enhanced independence requirements for members of compensation committees, it did not explicitly exempt other types of registered management investment companies, including closed-end funds, from any of the requirements of Rule 10C-1. Under the Nasdaq proposal, both closed-end and open-end funds would be exempt from all the requirements of the rule.

The commenter supported this aspect of the proposal, stating that both open-end and closed-end funds typically are externally managed and do not employ executives or by their nature have employees. The commenter believed that such funds are adequately governed by other federal regulation with respect to corporate governance matters, generally, and compensation matters, specifically.<sup>212</sup> The Commission believes that this exemption is reasonable because the Investment Company Act of 1940 already assigns important duties of investment company governance, such as approval

of the investment advisory contract, to independent directors, and because such entities were already generally exempt from Nasdaq's existing compensation committee requirements. The Commission notes that, as the commenter stated, that almost all registered investment companies do not employ executives or employees or have compensation committees.

The Commission notes that Nasdaq proposes, however, to amend its current rule for foreign private issuers, which allows such issuers to follow their home country practice in lieu of the Exchange's standards regarding a company's compensation decision-making process. The current rule includes the proviso that the issuer must disclose its reliance on the exemption. Nasdaq proposes to conform its rules in this regard with the provision of Rule 10C-1 permitting a foreign private issuer to follow home country practice only when it meets the additional condition that the issuer disclose the reasons why it does not have an independent compensation committee.

#### F. Transition to the New Rules for Companies Listed as of the Effective Date

The Commission believes that the deadlines for compliance with the proposal's various provisions are reasonable and should afford listed companies adequate time to make the changes, if any, necessary to meet the new standards. The Commission notes that the provision in the original proposal requiring companies to comply with certain of the requirements immediately has been revised in Amendment No. 1 to allow companies until July 1, 2013 to satisfy these requirements.<sup>213</sup> The Commission also believes that the revised deadline proposed in Amendment No. 1, which gives companies until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, to comply with the remaining provisions is more clear-cut than the deadline in the original proposal and also matches the deadline set forth by the New York Stock Exchange in its proposed rule change to comply with Rule 10C-1.<sup>214</sup>

#### G. Phase-In Schedules: IPOs; Companies That Lose their Exemptions; Companies Transferring From Other Markets

The Commission believes that it is reasonable for Nasdaq to allow, with

<sup>206</sup> See Securities Exchange Act Release No. 54421 (September 11, 2006), 71 FR 54698 (September 18, 2006) (approval of File No. NASDAQ-2006-011, modifying the cure period available to an issuer that loses an independent director or audit committee member).

<sup>207</sup> See *supra* note 154 and accompanying text.

<sup>208</sup> See, generally, Nasdaq Rule 5810.

<sup>209</sup> The Commission notes, moreover, that, in the case of limited partnerships and open-end registered management investment companies, Rule 10C-1 itself provides exemptions from the independence requirements of the Rule. The Commission notes that controlled companies are provided an automatic exemption from the application of the entirety of Rule 10C-1 by Rule 10C-1(b)(5). The additional Nasdaq provisions requiring listed companies to have a two-member compensation committee and a written committee charter, will, of course, not apply to the exempted entities, which are currently required to have neither a compensation committee nor the Alternative Option.

<sup>210</sup> See *supra* Section II.B.4.

<sup>211</sup> See ICI Letter.

<sup>212</sup> *Id.*

<sup>213</sup> See *supra* notes 73-74 for the provisions to which the new transition date applies.

<sup>214</sup> See Securities Exchange Act Release No. 68011 (October 9, 2012), 77 FR 62541 (October 15, 2012) (Notice of File No. SR-NYSE-2012-49).

respect to IPOs, companies emerging from bankruptcy, companies ceasing to be controlled companies, and companies transferring from other markets, the same phase-in schedule for compliance with the new requirements as is permitted under its current compensation-related rules.

The Commission also believes that the phase-in schedule for companies that cease to be Smaller Reporting Companies, as revised in Amendment No. 1, affords such companies ample time to come into compliance with the full panoply of rules that apply to other companies. In the Commission's view, the revised schedule also offers such companies more clarity in determining when they will be subject to the heightened requirements.

#### V. Accelerated Approval of Amendment Nos. 1 and 2 to the Proposed Rule Change

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>215</sup> for approving the proposed rule change, as modified by Amendment Nos. 1 and 2, prior to the 30th day after the date of publication of notice in the **Federal Register**. The change made to the proposal by Amendment No. 1 to set forth in detail the requirements of Rule 10C-1(b)(2)-(4) explicitly in the Exchange's rules, rather than incorporating these details by reference as in the original proposal,<sup>216</sup> is not a substantive one and merely codifies the original intent of that provision. Moreover, the change improves the proposal because it brings together the full set of the Exchange's rules on compensation committees in one place, thereby easing compliance for listed companies and benefiting investors seeking an understanding of an issuer's obligations with regard to determining executive compensation.

The change made by Amendment No. 1 to require companies currently listed on Nasdaq to comply with certain of the new rules by July 1, 2013 rather than immediately, as originally proposed,<sup>217</sup> reasonably affords companies more time to take the steps necessary for compliance. The change to require such companies to comply with the remaining provisions by the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, rather than by the deadline originally proposed,<sup>218</sup> still allows ample time for companies to adjust to the new rules, and accords with the deadline set by

NYSE in its proposed rule change to comply with Rule 10C-1, which was published at the same time as the Nasdaq proposal.<sup>219</sup>

The revision made by Amendment No. 1 to the phase-in rules for companies that cease to be Smaller Reporting Companies<sup>220</sup> establishes a schedule that is easier to understand, while still affording such companies adequate time to come into compliance. The Commission notes that the Start Date of the phase-in period for such a company is six months after the Determination Date, and the company is given no less than another six months from the Start Date to gain compliance with the rules from which it had been previously exempt. Moreover, with respect to the enhanced independence standards for compensation committee members (relating to fees and affiliation with the company), only one member must meet these standards within six months after the Start Date. The company is given nine months from the Start Date (*i.e.*, fifteen months from the Determination Date) to have a majority of committee members meeting the standards, and a full year from the Start Date (*i.e.*, eighteen months from the Determination Date) to fully comply with the standards.

The addition by Amendment No. 1 of a preamble to proposed Rule 5605(d) to set forth the obligations of a company during the transition period until the new rules apply introduces no substantive change.<sup>221</sup> It merely mirrors the instructions in the preamble to the Sunset Provisions, providing clarity for listed companies. The inclusion in Amendment No. 1 of language in Nasdaq's rules that requires a compensation committee to conduct the independence assessment with respect to "any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house counsel" merely reflects an instruction in Rule 10C-1 itself.<sup>222</sup> Finally, the addition of further guidance by Amendment No. 1 merely clarifies that nothing in the Exchange's

rules requires a compensation adviser to be independent, only that the compensation committee consider the independence factors before selecting or receiving advice from a compensation adviser,<sup>223</sup> and is not a substantive change.

Amendment No. 2 excluded advisers that provide certain types of services from the independence assessment.<sup>224</sup> As discussed above, the Commission has already determined to exclude such advisers from the disclosure requirement regarding compensation advisers in Regulation S-K because these types of services do not raise conflict of interest concerns. For all the reasons discussed above, the Commission finds good cause to accelerate approval of the proposed changes made by Amendment Nos. 1 and 2.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing and whether Amendment Nos. 1 and 2 are consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2012-109 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2012-109. This file number should be included on the subject line if email is used.

To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the

<sup>219</sup> The Commission received one comment letter relating to this provision in the NYSE proposal, in which the commenter supported this transition period for compliance with the new compensation committee independence standards but believed that a longer period should be provided to implement the other listing standards that NYSE proposed. See Letter to Elizabeth M. Murphy, Secretary, Commission, from Robert B. Lamm, Chair, Securities Law Committee, The Society of Corporate Secretaries & Governance Professionals, concerning File No. SR-NYSE-2012-49, dated December 7, 2012.

<sup>220</sup> See *supra* note 85 and accompanying text.

<sup>221</sup> See *supra* note 73.

<sup>222</sup> See *supra* note 194 and accompanying text.

<sup>223</sup> See *supra* note 56 and accompanying text.

<sup>224</sup> See *supra* notes 59-60 and accompanying text.

<sup>215</sup> 15 U.S.C. 78s(b)(2).

<sup>216</sup> See *supra* note 49 and accompanying text.

<sup>217</sup> See *supra* note 74 and accompanying text.

<sup>218</sup> See *supra* note 78 and accompanying text.

public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of Nasdaq. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2012-109, and should be submitted on or before February 12, 2013.

## VII. Conclusion

In summary, and for the reasons discussed in more detail above, the Commission believes that the rules being adopted by Nasdaq, taken as whole, should benefit investors by helping listed companies make informed decisions regarding the amount and form of executive compensation. Nasdaq's new rules will help to meet Congress's intent that compensation committees that are responsible for setting compensation policy for executives of listed companies consist only of independent directors.

Nasdaq's rules also, consistent with Rule 10C-1, require compensation committees of listed companies to assess the independence of compensation advisers, taking into consideration six specified factors. This should help to assure that compensation committees of Nasdaq-listed companies are better informed about potential conflicts when selecting and receiving advice from advisers. Similarly, the provisions of Nasdaq's standards that require compensation committees to be given the authority to engage and oversee compensation advisers, and require the listed company to provide for appropriate funding to compensate such advisers, should help to support the compensation committee's role to oversee executive compensation and help provide compensation committees with the resources necessary to make better informed compensation decisions.

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with the Act and the rules and regulations thereunder applicable to a national

securities exchange, and, in particular, with Section 6(b)(5) of the Act.<sup>225</sup>

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>226</sup> that the proposed rule change, SR-NASDAQ-2012-109, as modified by Amendment Nos. 1 and 2, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>227</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

[FR Doc. 2013-01107 Filed 1-18-13; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68639; File No. SR-NYSE-2012-49]

### Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Amendment No. 3, and Order Granting Accelerated Approval for Proposed Rule Change, as Modified by Amendment Nos. 1 and 3, To Amend the Listing Rules for Compensation Committees To Comply With Securities Exchange Act Rule 10C-1 and Make Other Related Changes

January 11, 2013.

#### I. Introduction

On September 25, 2012, New York Stock Exchange LLC ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to modify the Exchange's rules for compensation committees of listed issuers to comply with Rule 10C-1 under the Act and make other related changes. On October 1, 2012, NYSE filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1 thereto, was published for comment in the **Federal Register** on October 15, 2012.<sup>3</sup> The Commission subsequently extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change, to January 13,

2013.<sup>4</sup> The Commission received seven comment letters on the proposed rule change,<sup>5</sup> as well as a response to the comment letters from NYSE Euronext, Inc. regarding the NYSE proposal.<sup>6</sup> On December 4, 2012, the Exchange filed Amendment No. 2 to the proposed rule change, which was later withdrawn.<sup>7</sup> On January 8, 2013, the Exchange filed Amendment No. 3 to the proposed rule change.<sup>8</sup>

<sup>4</sup> See Securities Exchange Act Release No. 68313 (November 28, 2012), 77 FR 71853 (December 4, 2012).

<sup>5</sup> See Letters to Elizabeth M. Murphy, Secretary, Commission, from: Thomas R. Moore, Vice President, Corporate Secretary and Chief Governance Officer, Ameriprise Financial, Inc., dated October 18, 2012 ("Ameriprise Letter"); J. Robert Brown, Jr., Director, Corporate & Commercial Law Program, University of Denver Sturm College of Law, dated October 30, 2012 ("Brown Letter"); Dorothy Donohue, Deputy General Counsel, Securities Regulation, Investment Company Institute, dated November 1, 2012 ("ICI Letter"); Brandon J. Rees, Acting Director, Office of Investment, AFL-CIO, dated November 5, 2012 ("AFL-CIO Letter"); Carin Zelenko, Director, Capital Strategies Department, International Brotherhood of Teamsters, dated November 5, 2012 ("Teamsters Letter"); Wilson Sonsini Goodrich & Rosati, Professional Corporation, dated November 14, 2012 ("Wilson Sonsini Letter"); and Robert B. Lamm, Chair, Securities Law Committee, The Society of Corporate Secretaries & Governance Professionals, dated December 7, 2012 ("Corporate Secretaries Letter").

In addition, the Commission received one comment on a substantially similar proposal by NYSE Arca, Inc. ("NYSE Arca") by a party that did not specifically comment on the NYSE filing. See Securities Exchange Act Release No. 68006 (October 9, 2012), 77 FR 62587 (October 15, 2012) (SR-NYSEArca-2012-105). The comment letter received on the NYSE Arca filing is a letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Elizabeth M. Murphy, Secretary, Commission, dated November 1, 2012 ("CII Letter"). Since the comment letter received on the NYSE Arca filing discusses issues directly related to the NYSE filing, the Commission has included it in its discussion of this filing.

<sup>6</sup> See Letter to Elizabeth M. Murphy, Secretary, Commission, from Janet McGinness, Executive Vice President and Corporate Secretary, NYSE Euronext, Inc., dated January 10, 2013 ("NYSE Response Letter"). In the NYSE Response Letter, NYSE Euronext, Inc., the parent company of NYSE, states that, as the comments made by the letters submitted on the NYSE and NYSE Arca proposals are applicable in substance to NYSE, NYSE Arca and NYSE MKT LLC, its response will address the comments on behalf of all three exchanges.

<sup>7</sup> Amendment No. 2, dated December 4, 2012, was withdrawn on January 7, 2013.

<sup>8</sup> In Amendment No. 3 to SR-NYSE-2012-49, NYSE: (a) Revised the transition period for companies that cease to be Smaller Reporting Companies to comply with the full range of new requirements, see *infra* notes 70-73 and accompanying text; (b) changed references in the rule text from Regulation S-K, Item 10(f)(1) to Exchange Act Rule 12b-2; (c) added commentary to state that the independence assessment of compensation advisers required of compensation committees does not need to be conducted for advisers whose roles are limited to those entitled to an exception from the compensation adviser disclosure rules under Item 407(e)(3)(iii) of Regulation S-K, see *infra* notes 45-48 and accompanying text; and (d) added commentary to

<sup>225</sup> 15 U.S.C. 78f(b)(5).

<sup>226</sup> 15 U.S.C. 78s(b)(2).

<sup>227</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 68011 (October 9, 2012), 77 FR 62541 ("Notice").