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#### 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-Phlx-2013-01*. 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 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, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-Phlx-2013-01* and should be submitted on or before February 13, 2013.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>49</sup>

**Kevin M. O'Neill,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68653; File No. SR-CHX-2012-13]

### Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Amendment No. 3, and Order Granting Accelerated Approval for Proposed Rule Change, as Modified by Amendment Nos. 1, 2 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 14, 2013.

#### I. Introduction

On September 26, 2012, Chicago Stock Exchange, Inc. ("Exchange" or "CHX") 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 10, 2012, CHX filed Amendment Nos. 1 and 2 to the proposed rule change.<sup>3</sup> The proposed rule change, as modified by Amendment Nos. 1 and 2 thereto, was published for comment in the **Federal Register** on October 16, 2012.<sup>4</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 14, 2013.<sup>5</sup> The Commission received no comment letters on the proposal.<sup>6</sup> On January 7, 2013, the Exchange filed Amendment No. 3 to the proposed rule change.<sup>7</sup>

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

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

<sup>3</sup> Amendment No. 1 indicated that the proposal had been approved by CHX's board of directors on September 27, 2012. Amendment No. 2 replaced the original filing in full.

<sup>4</sup> See Securities Exchange Act Release No. 68033 (October 10, 2012), 77 FR 63370 ("Notice").

<sup>5</sup> See Securities Exchange Act Release No. 68311 (November 28, 2012), 77 FR 71852 (December 4, 2012).

<sup>6</sup> The Commission notes that comments were received on substantially similar proposals filed by New York Stock Exchange, LLC and The Nasdaq Stock Market LLC. For a discussion and summary of these comments see Securities Exchange Act Release Nos. 68011 (October 9, 2012) ("NYSE Notice") (File No. SR-NYSE-2012-49); 68013 (October 9, 2012) ("Nasdaq Notice") (File No. SR-NASDAQ-2012-109); 68639 (January 11, 2013) ("NYSE Approval Order"); and 68640 (January 11, 2013) ("Nasdaq Approval Order").

<sup>7</sup> In Amendment No. 3 to SR-CHX-2012-013, CHX: (a) Removed a proposed amendment to Rule

This order approves the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 thereto, on an accelerated basis.

#### II. Description of the 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 Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),<sup>8</sup> the Commission proposed Rule 10C-1 under the Act,<sup>9</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>10</sup>

Rule 10C-1 requires, among other things, each exchange to adopt rules providing that each member of the compensation committee<sup>11</sup> of a listed issuer must be a member of the board of directors of the issuer, and must otherwise be independent.<sup>12</sup> In determining the independence standards for members of compensation committees of listed issuers, Rule 10C-

4 concerning delisting standards, *see infra* notes 21-22 and accompanying text; (b) added commentary to state that the independence assessment of compensation advisers required of compensation committees does not need to be conducted for in-house counsel and 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 53-55 and accompanying text; and (c) added commentary to state that the independence assessment of compensation advisers required of compensation committees does not require the adviser to be independent, only that the compensation committee consider the enumerated factors before selecting or receiving advice from the adviser; *see infra* notes 56-58 and accompanying text; (d) removed a proposed exemption from the rule; and (e) reincorporated existing Rules 19(d) and 19(p)(3) as "sunset provisions" with text that would be effective until July 1, 2013, rather than delete them in their entirety and otherwise modified the transition schedule for currently listed companies with provisions of the proposed rule. *See infra* notes 72-74 and accompanying text.

<sup>8</sup> Public Law 111-203, 124 Stat. 1900 (2010).

<sup>9</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>10</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>11</sup> For a definition of the term "compensation committee" for purposes of Rule 10C-1, *see* Rule 10C-1(c)(2)(i)-(iii).

<sup>12</sup> See Rule 10C-1(a) and (b)(1).

<sup>49</sup> 17 CFR 200.30-3(a)(12).

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>13</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>14</sup> The exchange rules must also provide that each listed issuer provide for appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to any compensation adviser retained by the compensation committee.<sup>15</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>16</sup> as well as any other factors identified by the relevant exchange in its listing standards.<sup>17</sup>

#### B. CHX’s Proposed Rule Change as Amended

To comply with Rule 10C–1, CHX proposes to amend three sections of its rules in Article 22 concerning corporate governance requirements for companies listed on the Exchange: Rule 2, “Admittance to Listing;” Rule 19(d), “Corporate Governance—Compensation Committee;” and Rule 19(p)(3),

“Corporate Governance—Definitions—Independent Director.” In addition, CHX proposes to make some other changes to its rules regarding compensation committees. To accomplish these changes, the Exchange proposes to replace current Rules 19(d) and 19(p)(3) with new operative text that will be effective on July 1, 2013. Current Rules 19(d) and 19(p)(3), which would remain effective until June 30, 2013,<sup>18</sup> provides that compensation of the executive officers of a listed company shall 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.<sup>20</sup>

#### 1. Admittance to Listing

CHX proposes to clarify that the Exchange’s Board of Governors may only admit securities for listing “once the requirements of this Article are met.”<sup>21</sup> The Exchange believes that this modification largely adopts much of the current Rule 2, while only clarifying this fact.<sup>22</sup>

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

CHX proposes to retain its existing requirement that each issuer must have a compensation committee, composed entirely of Independent Directors, as defined in current Rule 19(p)(3),<sup>23</sup> to oversee executive compensation or, in the alternate, a majority of the issuer’s independent directors providing such oversight.<sup>24</sup> CHX proposes to modify, however, its definition of compensation committee to include the following three, rather than two, options: (1) A committee designated as a compensation committee; (2) in the absence of a committee designated as a

compensation committee, a committee performing functions typically performed by a compensation committee, including oversight of executive compensation, even if it performs other functions; or (3) in the absence of any such committees, the members of the board of directors who oversee executive compensation on behalf of the board, who together must comprise a majority of the board’s independent directors.<sup>25</sup> The existing alternative option to a formal committee, as described above, would therefore continue to be available to issuers. In addition, CHX proposes that the Independent Directors serving on a Compensation Committee must meet the additional requirements described below.<sup>26</sup>

CHX also proposes that an issuer must adopt a formal written charter or board resolution related to the Compensation Committee.<sup>27</sup> The charter or board resolution must address the scope of the Compensation Committee’s responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements.<sup>28</sup> Generally, the proposed rule would require the charter or board resolution to specify the Compensation Committee’s responsibilities 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 deliberation on his or her own compensation.<sup>29</sup> In addition, the charter or board resolution must specify the Compensation 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

<sup>13</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>14</sup> See Rule 10C–1(b)(2).

<sup>15</sup> See Rule 10C–1(b)(3).

<sup>16</sup> See Rule 10C–1(b)(4). The six factors, which CHX proposes to set forth in its rules, are specified in the text accompanying note 51, *infra*.

<sup>17</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>18</sup> See Amendment No. 3, *supra* note 7.

<sup>19</sup> “Independent Directors,” as defined in CHX Rule 19(p)(3) 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.*

<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 19(d)(1).

<sup>21</sup> See proposed Rule 2.

<sup>22</sup> See Notice, *supra* note 4.

<sup>23</sup> See proposed Rule 19(d)(1).

<sup>24</sup> See *id.*

<sup>25</sup> See proposed Rule 19(d)(1)(A)–(C). For ease of reference throughout this release, in our discussion of the CHX rules we are approving, references to an issuer’s “Compensation Committee” include all three options.

<sup>26</sup> See proposed Rule 19(d)(1). For the current definition of “Independent Director,” see *supra* note 19.

<sup>27</sup> See proposed Rule 19(d)(2). 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 14–16 and accompanying text, Rule 10C–1 does require a compensation committee to have certain specified authority and responsibilities. Often, listed issuers will specify authority and responsibilities of this kind in a charter in any case. The proposed rule requires issuers to have a charter or board resolution, and to include this authority and set of responsibilities in addition to the required content discussed *infra* at text accompanying notes 46–51.

<sup>28</sup> See proposed Rule 19(d)(2)(A).

<sup>29</sup> See proposed Rule 19(d)(2)(B); see also proposed Rule 19(d)(3).

and receiving advice from advisers; and receiving funding from the company to engage such advisers, which are discussed in detail below.<sup>30</sup>

As noted above, CHX's rules currently require each member of a listed company's Compensation Committee to be an Independent Director as defined in CHX Rule 19(p)(3).<sup>31</sup> CHX will retain Rule 19(p)(3), which would continue to contain the bright line test and provide that no director qualifies as "independent" unless the board of directors of the issuer affirmatively determines that the director has no relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. 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, CHX discussed its consideration of these factors,<sup>32</sup> and proposed the following:<sup>33</sup>

With respect to the Fees Factor and the Affiliation Factor, CHX proposes to adopt a provision stating that the board of directors of the listed company would be required, in affirmatively determining the independence of any director who will serve on the Compensation Committee of the board, to consider all factors specifically relevant to determining whether a director has a relationship to the issuer which is material to that director's ability to be independent from management in connection with the duties of a Compensation Committee member, including, but not limited to the following factors: (i) The source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the issuer to the director; and (ii) whether such director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.<sup>34</sup>

With respect to the Fees Factor, CHX also proposes additional guidance that

the board, when considering the sources of a director's compensation, should consider whether the director receives compensation from any person or entity that would impair the director's ability to make independent judgments about the issuer's executive compensation.<sup>35</sup>

With respect to the Affiliation Factor, CHX proposes, similarly, to provide additional guidance to provide that the board should consider whether an affiliate relationship places the director under the direct or indirect control of the listed company or its senior management, or creates a direct relationship between the director and members of senior management, " \* \* \* in each case of a nature that would impair her ability to make independent judgments about the issuer's executive compensation."<sup>36</sup>

Although Rule 10C-1 requires that exchanges consider "relevant factors" not limited to the Fees Factor and Affiliation Factor, CHX states that, after reviewing its current and proposed listing rules, it concluded not to propose any specific numerical tests with respect to the factors specified in proposed Rule 19(p)(3)(B) or to adopt a requirement to consider any other specific factors.<sup>37</sup> In its proposal, CHX stated that it did not intend to adopt an absolute prohibition on a board making an affirmative finding that a director is independent solely on the basis that the director or any of the director's affiliates are shareholders owning more than some specified percentage of the issuer.<sup>38</sup> Further, as stated in its filing, CHX believes that its existing "bright-line" independence standards, as set forth in current Rule 19(p)(3)(A)-(G), and the additional independence requirements proposed in Rule 19(p)(3)(B) are sufficiently broad to encompass the types of relationships which would generally be material to a director's independence for compensation committee service.<sup>39</sup> Additionally, CHX stated that Rule 19(p)(3) already requires the board to consider any other material relationships between the director and the issuer or its management that are not the subject of "bright-line" tests in existing Rule 19(p)(3)(A)-(G).<sup>40</sup> CHX believes that these requirements with respect to general director

independence, when combined with the specific considerations required by proposed Rule 19(p)(3)(B), represent an appropriate standard for compensation committee independence.<sup>41</sup>

CHX proposes a cure period for a failure of a listed company to meet its Compensation Committee composition requirements for independence. Under the provision, if a member of an issuer's compensation committee or functional equivalent ceases to be an independent director for reasons outside the member's reasonable control, that member may remain a member of the compensation committee or functional equivalent until the earlier of the next annual shareholders meeting of the issuer or one year from the occurrence of the event that caused the member to no longer be an independent director.<sup>42</sup> The proposed rule also requires a company relying on this provision to provide notice to CHX promptly.<sup>43</sup>

CHX also proposes Rule 19(d)(5)(A)(i) to make an exception that allows a director who is not independent to be temporarily appointed to such a committee under exceptional and limited circumstances, as long as that director is not currently an officer, employee or family member of a current officer or employee. The exception applies, however, only if the committee is comprised of at least three members and the board determines that the individual's membership on the committee is required in the best interests of the company and its shareholders.<sup>44</sup> CHX believes this exception will allow issuers to efficiently deal with unforeseen and exceptional circumstances, so as to ensure the smooth function of its compensation committee or functional equivalent, while minimizing the risk of abuse.<sup>45</sup>

<sup>41</sup> See Notice, *supra* note 4.

<sup>42</sup> See proposed Rule 19(d)(5)(A)(ii). CHX stated that its proposed rule outlines the opportunity to cure defects almost precisely as stated in Rule 10C-1. See Notice, *supra* note 4.

<sup>43</sup> See proposed Rule 19(d)(5)(A)(ii). CHX does not otherwise propose any new procedures for an issuer to have an opportunity to cure defects with respect to its proposed requirements, but CHX does have existing delisting procedures that provide issuers with notice, opportunity for a hearing, opportunity for appeals, and an opportunity to cure defects before an issuer's securities are delisted. See Article 22, Rule 4, "Removal of Securities." For example, Rule 4(b) provides procedure for providing deficient companies with notice; Rule 4(c)-(d) provides procedures for an issuer to avail itself of a hearing; and Rule 4(e) provides procedures for issuers to appeal to CHX's Executive Committee.

<sup>44</sup> See proposed Rule 19(d)(5)(A)(i).

<sup>45</sup> See Notice, *supra* note 4.

<sup>30</sup> See proposed Rule 19(d)(2)(C); see also proposed Rule 19(d)(4) and *infra* notes 47-51 and accompanying text. Because smaller reporting companies are not required to comply with the provisions relating to compensation advisers in proposed CHX Rule 19(d)(4), see *infra* notes 61-62, their charters or board resolutions are not required to reflect these responsibilities.

<sup>31</sup> See *supra* note 19.

<sup>32</sup> See Notice, *supra* note 4.

<sup>33</sup> These additional factors would not apply to the selection of members of the Compensation Committee of a smaller reporting company.

<sup>34</sup> See proposed Rule 19(p)(3)(B).

<sup>35</sup> See proposed Rule 19(p)(3)(B)(i).

<sup>36</sup> See proposed Rule 19(p)(3)(B)(ii).

<sup>37</sup> See Notice, *supra* note 4.

<sup>38</sup> See Notice, *supra* note 4.

<sup>39</sup> See Notice, *supra* note 4. CHX proposes to reorganize the numbering of its existing bright-line tests to allow for the inclusion of additional factors specific to compensation committees. See proposed Rule 19(p)(3)(A)(i)-(vii).

<sup>40</sup> See Notice, *supra* note 4.

### 3. Authority of Committees To Retain Compensation Advisers; Funding; and Independence of Compensation Advisers and Factors

In its proposed rule change, CHX proposes to fulfill the requirements imposed by Rule 10C-1(b)(2)-(4) under the Act concerning compensation advisers by setting forth those requirements in its own rules and requiring these new rights and responsibilities to be included in the compensation committee's charter or board resolution.<sup>46</sup> Thus, proposed Rule 19(d)(4)(A)-(B) and (D) proposes to adopt the requirements that CHX believes are required by Rule 10C-1(b)(2)-(3) that: (A) The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation consultant, legal counsel or other adviser;<sup>47</sup> (B) the Compensation Committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, legal counsel or other adviser retained by the Compensation Committee;<sup>48</sup> and (D) 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>49</sup>

<sup>46</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 proposed Rule 19(d)(4)(F), as modified by Amendment No. 3, CHX provides for two limited exceptions. See *infra* notes 53-55 and accompanying text.

<sup>47</sup> CHX proposes that this requirement will not apply to issuers that do not maintain a formal committee of the board of directors for determining executive compensation. As noted by CHX, the reason behind this exclusion is that since an action by independent directors acting outside of a formal committee structure would generally be considered action by the full board of directors, it is unnecessary to apply this requirement to directors acting outside of a formal committee structure, as they retain all the powers of the board of directors in making executive compensation determinations. See Notice, *supra* note 4.

<sup>48</sup> The proposal also includes a provision, derived from Rule 10C-1, stating that nothing in the rule may be construed to require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel or other adviser to the compensation committee; nor to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee. See proposed Rule 19(d)(4)(C).

<sup>49</sup> See Notice, *supra* note 4. CHX proposes that this requirement will not apply to issuers that do not maintain a formal committee of the board of directors for determining executive compensation. In Amendment No. 3, CHX removed the word "independent" from the term "legal counsel" used in proposed Rule 19(d)(4)(A)-(D) to conform the

Proposed Rule 19(d)(4)(E), 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, other than in-house legal counsel, only after taking into consideration the following six factors set forth in Rule 10C-1 regarding independence assessments of compensation advisers.<sup>50</sup>

The six factors, which are set forth in full in the proposed rule, are: (i) The provision of other services to the listed company 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>51</sup>

As proposed, Rule 19(d)(4)(F) would not include any specific additional factors for consideration, as CHX stated that it believes that this list will require compensation committees and functional equivalents to consider a variety of factors that may bear upon the likelihood that a compensation adviser can provide independent advice to the Compensation Committee, but will not prohibit committees from choosing any particular adviser or type of adviser.<sup>52</sup>

Proposed Rule 19(d)(4)(F), as modified by Amendment No. 3,<sup>53</sup> further states that, as provided in Rule

instructions with guidance now provided in Rule 19(d)(4)(F), as amended. See Amendment No. 3, *supra* note 7.

<sup>50</sup> See Rule 10C-1(b)(4).

<sup>51</sup> See also Rule 10C-1(b)(4)(i)-(vi).

<sup>52</sup> See Notice, *supra* note 4.

<sup>53</sup> See *supra* note 7. CHX's proposal as submitted originally only contained an exception for in-house legal counsel. As described below, the Exchange amended its proposal to add an exception for advisers whose role is limited to certain broad-based plans or to providing non-customized information.

10C-1, a Compensation Committee is required to conduct the independence assessment outlined in proposed Rule 19(d)(4)(E) with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than (i) in-house legal counsel<sup>54</sup> and (ii) any compensation consultant, legal counsel or other adviser whose role is limited to the following activities for which no disclosure would be required under Item 407(e)(3)(iii) of Regulation S-K: Consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the listed company, and that is available generally to all salaried employees; or providing information that either is not customized for a particular company or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.<sup>55</sup>

Proposed Rule 19(d)(4)(F), as modified by Amendment No. 3, 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 Rule 19(d)(4)(E).<sup>57</sup> The Exchange clarified that, while the Compensation Committee is required to consider the independence of compensation advisers, the Compensation Committee is not precluded from selecting or receiving advice from compensation advisers that are not independent.<sup>58</sup>

### 4. Application to Smaller Reporting Companies

Rule 10C-1 includes an exemption for smaller reporting companies from all the requirements included within the Rule.<sup>59</sup> Consistent with this Rule 10C-1 provision, CHX, as a general matter, proposes that a smaller reporting

<sup>54</sup> See proposed Rule 19(d)(4)(F).

<sup>55</sup> See Amendment No. 3, *supra* note 7, and proposed Rule 19(d)(4)(F).

<sup>56</sup> See Exhibit 5 to Amendment No. 3, *supra* note 7.

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

<sup>58</sup> See Amendment No. 3, *supra* note 7.

<sup>59</sup> See *supra* Section II.A; see also Rule 10C-1(b)(5)(ii).

company, as defined in Rule 12b-2<sup>60</sup> 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>61</sup> Thus, CHX proposes not to require Smaller Reporting Companies to comply with either the enhanced independence standards for members of compensation committees relating to compensatory fees and affiliation or the compensation adviser authority and funding requirements or adviser independence considerations.

CHX notes that, under current CHX rules, Smaller Reporting Companies are already subject to the general independence requirements for compensation committees, and as such, CHX believes that requiring such issuers to continue to comply with existing standards is not overly burdensome.<sup>62</sup>

#### 5. Exemptions

CHX proposes to exempt six categories of issuers from all of the compensation committee requirements of Rule 19(d).<sup>63</sup> These include exemptions to the following issuers: limited partnerships;<sup>64</sup> companies in bankruptcy;<sup>65</sup> closed-end and open-end management companies that are registered under the Investment Company Act of 1940 (“Investment Company Act”);<sup>66</sup> passive business organizations (such as royalty trusts) or derivatives and special purpose entities;<sup>67</sup> issuers listing only preferred

or debt securities;<sup>68</sup> and controlled companies.<sup>69</sup>

Concerning foreign private issuers,<sup>70</sup> CHX current commentary in Paragraph .03(4) of the Interpretations and Policies of Rule 19 permits any such issuer to follow its home country practice in lieu of many of CHX’s corporate governance listing standards, including the Exchange’s compensation-related listing rules. Paragraph .03(4) current provides that foreign private issuers are permitted to follow home country practice in lieu of the provisions of Rule 19(d), but this allowance is granted on condition that the issuer discloses in its annual report filed with the Commission any significant ways in which its corporate governance practices differ from those followed by domestic companies under CHX-listing standards. Under proposed 19(d)(5)(B)(iv), CHX proposes that this continue to apply to the new compensation related requirements, so long as the foreign private issuer also discloses in its annual report the reasons that it does not have an independent compensation committee. CHX believes that foreign private issuers are already subject to corporate regulations of their respective home countries and requiring such issuers to comport with Rule 10C-1 would be cumulative, if not contradictory.<sup>71</sup>

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

The proposed rule change, as amended, provides that certain of the new requirements for listed companies will be effective on July 1, 2013 and others will be effective after that date.<sup>72</sup> Specifically, CHX proposes to amend the Interpretations and Policies .05(6) to Rule 19 to provide transition periods by which listed companies would be required to comply with the new Rule

19(p)(3)(B) compensation committee director independence standards. Pursuant to the proposal, listed companies would have until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, to comply with the new standards for compensation committee director independence.<sup>73</sup> Existing compensation committee independence standards would continue to apply pending the transition to the new independence standards. CHX proposes that all other proposed sections would become effective on July 1, 2013 for purposes of compliance by currently listed issuers that are not otherwise exempt.<sup>74</sup>

#### 7. Compliance Schedules: IPOs; Companies Transferring From Other Markets and Smaller Reporting Companies

With respect to issuers listing securities on the Exchange in connection with an initial public offering, existing CHX Interpretation and Policy .05(3) provides that such issuers will be required to comply with the new governance standards for each applicable committee that the issuer establishes. Specifically, under the rule, the compensation committee for the issuer must have one independent member at the time of listing, a majority of independent members within 90 days of listing and all independent members within one year.

With respect to companies that transfer from other markets, existing CHX Interpretation and Policy .05(4) to Rule 19 provides that (1) any issuers transferring during another market’s transition period to new governance standards will be allowed to comply with CHX’s requirements within any transition period that has been provided by the other marketplace and (2) any issuer transferring from a market that does not have governance standards substantially similar to CHX shall have one year from the date of listing to be in compliance. CHX does not propose to change this rule, and so it will also apply to the newly adopted portions of Rules 19(d) and 19(p), described above.

CHX proposes to create a compliance schedule for companies that cease to be

<sup>60</sup> 17 CFR 240.12b-2.

<sup>61</sup> See proposed Rule 19(d)(5)(C).

<sup>62</sup> See Notice, *supra* note 4.

<sup>63</sup> See *id.* In addition, such exempt companies would also thereby be exempt from the enhanced independence requirements for compensation committee composition described in proposed Rule 19(p)(3)(B). See also proposed Rule 19(d)(5)(B).

<sup>64</sup> CHX notes that limited partnerships are already exempt from the current compensation committee requirements because the Exchange believes the ownership/management structure renders the independent director requirements inapplicable and argues the same reasoning renders the adviser requirements unnecessary. See Notice, *supra* note 4.

<sup>65</sup> CHX believes exempting such companies will avoid overburdening issuers struggling to emerge from bankruptcy. See Notice, *supra* note 4. Like limited partnerships, such companies are already exempt from existing requirements under paragraph .03(1) of the Interpretations and Policies of Rule 19.

<sup>66</sup> CHX believes that, because investment companies are already subject to the requirements of the Investment Company Act, including requirements concerning potential conflicts of interest related to investment adviser compensation, Rule 19(d) would be duplicative and unnecessary. See Notice, *supra* note 4.

<sup>67</sup> CHX believes that such entities are structured fundamentally different from conventional issuers. See Notice, *supra* note 4.

<sup>68</sup> CHX believes such issuers, which are already exempt from existing requirements on CHX, should continue to be exempt from the additional requirements of Rule 10C-1 because they are either often subject to requirements of the exchange where they are primarily listed, often provide stockholders with significantly greater protections, or do not impart ownership interest. See Notice, *supra* note 4.

<sup>69</sup> CHX notes that controlled companies are already exempt from existing compensation committee requirements under existing Rule 19(d)(3)(B) and will continue to be exempt from existing and proposed compensation committee requirements under proposed Rule 19(d)(5)(B)(vi).

<sup>70</sup> CHX proposes, in Rule 19(d)(5)(B)(iv), that the term “foreign private issuer” will have the same meaning as Rule 3b-4 under the Exchange Act for purposes of Rule 19.

<sup>71</sup> See Notice, *supra* note 4.

<sup>72</sup> During the transition periods described herein, existing compensation committee independence standards would continue to apply pending the transition to the new independence standards.

<sup>73</sup> CHX originally proposed that this transition period would also apply to the charter or board resolution and adviser independence consideration, but has amended these transition periods to require that issuers must comply with these requirements by July 1, 2013. See Amendment No. 3, *supra* note 7.

<sup>74</sup> CHX originally proposed that these transitions would become effective immediately upon approval by the Commission, but has amended these transition periods to require that issuers must comply by July 1, 2013. See Amendment No. 3, *supra* note 7.

a Smaller Reporting Company. To the extent a Smaller Reporting Company ceases to qualify as such, the proposed rule change, as modified by Amendment No. 2, establishes a compliance schedule based on certain dates relating to the company's change in status.<sup>75</sup> Specifically, such a company would be required, if otherwise applicable, to: (i) Have a compensation committee of which the members meet the additional independence requirements of Rule 19(p)(3)(B) within six months of the date on which the issuer failed to qualify as a smaller reporting company and (ii) comply with Rule 19(d)(4) concerning compensation advisers as of the date on which the issuer failed to qualify as a Smaller Reporting Company.

### III. Discussion and Commission Findings

After careful review, the Commission finds that the CHX proposal, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>76</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>77</sup> as well as with Section 10C of the Act<sup>78</sup> and Rule 10C-1 thereunder.<sup>79</sup> Specifically, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,<sup>80</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 CHX 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>81</sup> Congress resolved to require that "board committees that set compensation policy will consist only of directors who are independent."<sup>82</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, CHX 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 believes that the proposed rule change, as modified by Amendment Nos. 1, 2 and 3, appropriately revises CHX's rules for Compensation Committees of listed companies, for the following reasons:

#### A. Admittance to Listing

The Commission believes that the clarification to the admittance to listing standards, which makes explicit the fact that the Exchange's Board of Governors may only admit securities for listing once the requirements of Article 22,

which contains the Exchange's listing standards, are met, is reasonable and consistent with the Act. The Commission agrees with CHX that the modification largely adopts much of current Rule 2, while only clarifying an existing fact with respect to listing securities on CHX.<sup>83</sup>

#### B. Compensation Committee Composition

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 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>84</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, CHX proposes to maintain its requirements that an issuer have a compensation committee, composed entirely of independent directors, as defined in current Rule 19(p)(3), to oversee executive compensation, or in the alternate, a majority of the independent directors providing such oversight.<sup>85</sup> However, the Exchange proposes to modify its definition of compensation committee

<sup>75</sup> See proposed Rule 19(d)(5)(C). In the proposal as originally submitted, the compliance schedule was to require compliance immediately with all requirements.

<sup>76</sup> In approving the CHX proposed rule change, as amended, the Commission has considered its impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>77</sup> 15 U.S.C. 78f(b).

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

<sup>79</sup> 17 CFR 240.10C-1.

<sup>80</sup> 15 U.S.C. 78f(b)(5).

<sup>81</sup> See *supra* note 8.

<sup>82</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>83</sup> See Notice, *supra* note 4.

<sup>84</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 Act.

<sup>85</sup> See Rule 19(d)(1).

to include the following three options: (1) A committee designated as a compensation committee; (2) in the absence of a committee designated as a compensation committee, a committee performing functions typically performed by a compensation committee, including oversight of executive compensation; or (3) in the absence of any such committees, the members of the board of directors who oversee executive compensation on behalf of the board, who together must comprise a majority of the board's independent directors. The alternative option to a formal committee, as described above, would therefore continue to be available to issuers. The Commission believes that these three alternatives are consistent with the definitions provided Rule 10C-1, and should provide issuers with flexibility while continuing to ensure Independent Director oversight of executive compensation.

In addition to retaining its existing independence standards that currently apply to board and Compensation Committee members, which include certain bright-line tests,<sup>86</sup> CHX has enhanced its listing requirements regarding Compensation Committees by adopting additional standards for independence to comply with the Fees Factor and Affiliation Factor, as well as the other standards set forth in Rule 10C-1. The CHX's proposal also adopts the cure procedures provided as an option in Rule 10C-1(a)(3) for Compensation Committee members who cease to be independent for reasons outside their reasonable control.

Further, as discussed in more detail below, the CHX proposal adopts the requirement that the Compensation Committee have a written charter or board resolution that addresses the committee's purpose and responsibilities, and adds requirements to specify the compensation committee's authority and responsibilities as to compensation advisers as set forth under Rule 10C-1. Taken as a whole, the Commission believes that these changes will strengthen the oversight of executive compensation in CHX-listed companies and further greater accountability, and will therefore further the protection of investors consistent with Section 6(b)(5) of the Act.

The Commission believes that the Exchange's proposal, which requires the consideration of the additional independence factors for Compensation Committee members, is designed to

protect investors and the public interest and is consistent with the requirements of Sections 6(b)(5) and 10C of the Act and Rule 10C-1 thereunder.

With respect to the Fees Factor of Rule 10C-1, the Exchange rules state when considering the source of a director's compensation in determining independence for Compensation Committee service, the board should consider whether the director receives compensation from any person or entity that would impair his ability to make independent judgments about the listed company's executive compensation. In addition to the continued application of the CHX's current independence standards and bright-line tests, CHX's new rules also require the board to consider all relevant factors in making independence determinations for Compensation Committee membership. The Exchange believes that these requirements of proposed Article 19(p)(3)(B) of the Exchange's Rules, in addition to the general director independence requirements, represent an appropriate standard for Compensation Committee independence that is consistent with the requirements of Rule 10C-1 and the Fees Factor.

The Commission believes that the provisions noted above to address the Fees Factor give a board broad flexibility to consider a wide variety of fees, including any consulting, advisory or other compensatory fee paid by the issuer or entity, when considering a director's independence for compensation committee service. While the Exchange does not bar all compensatory fees, the approach is consistent with Rule 10C-1 and provides a basis for a board to prohibit a director from being a member of the Compensation Committee, should the director receive compensation that impairs the ability to make independent decisions on executive compensation matters, even if that compensation does not exceed the threshold in the bright-line test.<sup>87</sup> The Commission, therefore, believes that the proposed compensatory fee requirements comply with Rule 10C-1 and are designed to protect investors and the public interest, consistent with Section 6(b)(5) of the Act. The Commission notes that the compensatory fee consideration may help ensure that Compensation Committee members are less likely to have received fees, from either the issuer or another entity, which could potentially influence their decisions on compensation matters.

With respect to the Affiliation Factor of Rule 10C-1, CHX 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. Under CHX's rules, it may be appropriate for certain affiliates, such as representatives of significant stockholders, to serve on Compensation Committees. The Exchange has provided guidance that the board should consider whether an affiliate relationship places the director under the direct or indirect control of the listed company or its senior management, "in each case of a nature that would impair her ability to make independent judgments about the issuer's executive compensation."<sup>88</sup> The Commission believes that CHX'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>89</sup> In determining that CHX's affiliation standard is consistent with Sections 6(b)(5) and 10C under the Act, the Commission notes that CHX'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. The CHX rule further states that, in considering affiliate relationships, a board should consider whether such affiliate

<sup>86</sup> See proposed Rule 19(p)(3)(B)(ii).

<sup>89</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 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 his ability to make independent judgment" as a member of the committee. See also *supra* notes 36-41 and accompanying text.

<sup>86</sup> See Notice, *supra* note 4. See also *supra* note 19.

<sup>87</sup> See *supra* note 39, referencing the seven existing bright-line tests.

relationship places the director under the direct or indirect control of the listed company or its senior management such that it would impair the ability of the director to make independent judgments on executive compensation. 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 or its senior management.

As to whether CHX should adopt any additional relevant independence factors, the Exchange stated that it reviewed its rules in light of Rule 10C-1, and concluded that its existing rules together with its proposed rules are sufficiently broad to encompass the types of relationships which would generally be material to a director's independence for Compensation Committee service. 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 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 exchange's proposal to reflect any such additional factors.

CHX also 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.

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 CHX's current rules with respect to compensation committees, as well as for nominations

committees and audit committees.<sup>90</sup> 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.

In summary, the Commission believes the flexibility provided in CHX's new Compensation Committee independence standards provides companies with guidance, while allowing them to identify those relationships that might raise questions of independence for service on the compensation committee. It provides further flexibility for companies in circumstances where one member of the committee ceases to meet the independence requirements, under specified conditions, for reasons outside the member's reasonable control. For these reasons, we believe the independence standards are consistent with the investor protection provision of Section 6(b)(5) of the Act.

#### *C. Authority of Committees To Retain Compensation Advisers; Funding; and Independence of Compensation Advisers and Factors*

As discussed above, CHX 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. As such, the Commission believes these provisions meet the mandate of Rule 10C-1<sup>91</sup> and are consistent with the Act.<sup>92</sup>

In addition, the Commission believes that requiring companies to specify the enhanced compensation committee responsibilities through the Compensation Committee's written charter or board resolution will help to assure that there is adequate transparency as to the rights and responsibilities of compensation committee members. 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,

<sup>90</sup> See Securities Exchange Act Release No. 49911 (June 24, 2004), 69 FR 39989 (July 1, 2004) (order approving File No. CHX-2003-19).

<sup>91</sup> See Rule 10C-1.

<sup>92</sup> 15 U.S.C. 78j-3.

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.

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, CHX has proposed, in Amendment No. 3, to add language to the provision regarding the independence assessment of compensation advisers<sup>93</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. 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>94</sup>

The Commission views CHX'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>95</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

<sup>93</sup> See proposed Rule 19(d)(4)(F), as amended by Amendment No. 3.

<sup>94</sup> See 17 CFR 229.407(e)(3)(iii).

<sup>95</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.")



required to implement Section 10C(c)(2). The Commission also believes that the exception should allay some of the concerns raised by the commenters to other filings regarding the scope of the independence assessment requirement.<sup>96</sup> 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 independence assessment requirement, 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. 3, CHX 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>97</sup>

Finally, one commenter on the New York Stock Exchange LLC's proposal requested guidance "on how often the required independence assessment should occur."<sup>98</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.<sup>99</sup>

The changes to CHX's rules on compensation advisers should therefore benefit investors in CHX-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.

#### D. Application to Smaller Reporting Companies

The Commission believes that the requirement for Smaller Reporting Companies, like all other CHX-listed companies, to have a compensation committee, composed solely of independent directors or to otherwise

have compensation determined by a majority of the independent directors, is reasonable and consistent with the protection of investors. The Commission notes that CHX'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.<sup>100</sup>

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 CHX to provide some flexibility to Smaller Reporting Companies. Further, in view of the potential additional costs, it is reasonable not to require a Smaller Reporting Company to comply with these additional requirements.<sup>101</sup>

#### E. 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 CHX proposes for companies that fail to comply with the enhanced independence requirements designed to comply with Rule 10C-1 is the same as the cure period suggested under Rule 10C-1. The Commission believes that providing this cure provision as an option for independent directors who cease to be independent for reasons outside their control is fair and reasonable and consistent with investor protection under Rule 6(b)(5). In

addition, CHX's general rules include delisting procedures that provide issuers with notice, opportunity for a hearing, opportunity for appeals, and an opportunity to cure defects before an issuer's securities are delisted.

The Commission believes that these general procedures for companies out of compliance with listing requirements, in addition to the particular cure provisions for compensation committees 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.

#### F. Exemptions

The Commission believes that it is appropriate for CHX to exempt from the new requirements established by the proposed rule change the same categories of issuers that are exempt from its existing standards for oversight of executive compensation for listed companies. Although Rule 10C-1 does not explicitly exempt some of these categories of issuers from its requirements, it does grant discretion to exchanges to provide additional exemptions. CHX states that the reasons it adopted the existing exemptions apply equally to the new requirements, and the Commission believes that this assertion is reasonable.

CHX proposes to exempt limited partnerships, companies in bankruptcy, and open-end investment management companies registered under the Investment Company Act from all of the requirements of Rule 10C-1. The Commission believes such exemptions are reasonable, and notes that such entities, which were already generally exempt from CHX's existing compensation committee requirements, also are exempt from the compensation committee independence requirements specifically under Rule 10C-1. CHX also proposes to exempt closed-end management investment companies registered under the Investment Company Act from the requirements of Rule 10C-1. The Commission believes that this exemption is reasonable because the Investment Company Act 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 CHX's existing compensation committee requirements.

The Commission further believes that other proposed exemption provisions

<sup>96</sup> See NYSE Approval Order and Nasdaq Approval Order, *supra* note 6.

<sup>97</sup> See *supra* notes 56-58 and accompanying text.

<sup>98</sup> See Comment to NYSE Notice by Robert B. Lamm, Chair, Securities Law Committee, The Society of Corporate Secretaries & Governance Professionals, dated December 7, 2012.

<sup>99</sup> See NYSE Approval Order and Nasdaq Approval Order, *supra* note 6 for a discussion of comments.

<sup>100</sup> See Notice, *supra* note 4.

<sup>101</sup> As discussed *supra* notes 60-62 and accompanying text, under CHX's proposal, Smaller Reporting Companies are exempted from all of the compensation adviser requirements, including the requirement that specified independence factors be considered before selecting such advisers.

relating to controlled companies,<sup>102</sup> passive business organizations or derivative and special purpose entities, and issuers whose only listed equity stock is a preferred stock or debt security are reasonable, given the specific characteristics of these entities identified by CHX.<sup>103</sup>

The CHX proposal would continue to permit foreign private issuers to follow home country practice in lieu of the provisions of the new rules, but would now require further disclosure from such entities regarding the reason why they do not have an independent compensation committee. The Commission believes that granting exemptions to foreign private issuers in deference to their home country practices with respect to compensation committee practices is appropriate, and believes that the existing and proposed disclosure requirements will help investors determine whether they are satisfied with the alternative standard. The Commission also notes that CHX's proposal conforms its rules to Rule 10C-1, which exempts foreign private issuers from the compensation committee independence requirements of Rule 10C-1 to the extent such entities disclose in their annual reports the reasons they do not have independent compensation committees.

#### *G. 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, as amended, are reasonable and should afford listed companies adequate time to make the changes, if any, necessary to meet the new standards. The Commission believes that the July 1, 2013 deadline proposed is clear-cut and matches the deadline set forth by NYSE and The NASDAQ Stock Market, as revised.<sup>104</sup> Additionally, the amended deadline gives companies until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, to comply with the enhanced independence standards for the

members of compensation committees in Rule 19(p)(3)(B).<sup>105</sup>

#### *H. Compliance Schedules: Companies Transferring From Other Markets*

The Commission believes that it is reasonable for CHX to allow, with respect to companies listing in connection with an initial public offering 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 compliance schedule for companies that cease to be Smaller Reporting Companies, as revised in Amendment No. 2, is adequate time to come into compliance with the rules that apply to other companies.

#### **IV. Accelerated Approval of Amendment No. 3 to the Proposed Rule Change**

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>106</sup> for approving the proposed rule change, as modified by Amendment Nos. 1, 2 and 3, 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. 3 to remove a proposed amendment to Rule 4 is not substantive, as Rule 4's listing standards will now not be changed. For the same reason, the removal of the proposed general exemption for clearing agencies clearing futures or options from the rule is not a substantive change.<sup>107</sup>

The additional language in Amendment No. 3 to exclude advisers that provide only certain types of services from the independence assessment is also appropriate. 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. Similarly, the addition of further guidance by Amendment No. 3 merely clarifies that the same exception applies for in-house legal counsel, and is not a substantive change, as it was the intent of the rule as originally proposed.

Next, the addition of further guidance by Amendment No. 3 merely clarifies that nothing in the Exchange's rules require a compensation adviser to be independent, only that the compensation committee consider the independence factors before selecting or receiving advice from a compensation adviser, and that is not a substantive change, as it was also the intent of the rule as originally proposed.

Finally, the change made by Amendment No. 3 to require companies currently listed on CHX to comply with the majority of the new rules by July 1, 2013, rather than immediately, as originally proposed, reasonably affords companies more time to take the steps necessary for compliance. The change to require such companies to comply with the charter and compensation adviser consideration provisions by July 1, 2013, rather than, as originally proposed, the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, still allows ample time for companies to adjust to the new rules, and accords with the deadline set by NYSE and Nasdaq in their proposals to comply with Rule 10C-1.<sup>108</sup>

Similarly, the conforming insertion of the current rule language as a sunset provision merely makes clear what issuers will be required to comply with prior to the effectiveness of the new rule text.

For all the reasons discussed above, the Commission finds good cause to accelerate approval of the proposed changes made by Amendment No. 3.

#### **V. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing and whether Amendment No. 3 is consistent with the Act. Comments may be submitted by any of the following methods:

<sup>108</sup> See Securities Exchange Act Release Nos. 68011 (October 9, 2012), 77 FR 62541 (October 15, 2012) (Notice of File No. SR-NYSE-2012-49); 68013 (October 9, 2012), 77 FR 62563 (October 15, 2012) (Notice of File No. SR-NASDAQ-2012-109); see also Amendment No. 1 to File No. SR-NASDAQ-2012-109.

<sup>102</sup> 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).

<sup>103</sup> See *supra* notes 64-69 and accompanying text.

<sup>104</sup> See Securities Exchange Act Release Nos. 68011 (October 9, 2012), 77 FR 62541 (October 15, 2012) (Notice of File No. SR-NYSE-2012-49); 68013 (October 9, 2012), 77 FR 62563 (October 15, 2012) (Notice of File No. SR-NASDAQ-2012-109); see also Amendment No. 1 to File No. SR-NASDAQ-2012-109.

<sup>105</sup> The proposal is, however, otherwise effective on July 1, 2013, and issuers will be required to comply with the new compensation committee charter (or board resolution) and adviser requirements as of that date. As noted above, certain existing issuers, such as Smaller Reporting Companies, are exempt from compliance with the new independence requirement with respect to compensation committee service.

<sup>106</sup> 15 U.S.C. 78s(b)(2).

<sup>107</sup> The Commission notes that the listing of a security futures product cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q-1(b)(7)(A)) and the listing of a standardized option, as defined in § 240.9b-1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) are provided an automatic exemption from the application of the entirety of Rule 10C-1 by Rule 10C-1(b)(5).

### 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-CHX-2012-13 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-CHX-2012-13. 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 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 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of CHX. 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-CHX-2012-13, and should be submitted on or before February 13, 2013.

### VI. Conclusion

In summary, and for the reasons discussed in more detail above, the Commission believes that the rules being adopted by CHX, taken as whole, should benefit investors by helping listed companies make informed decisions regarding the amount and form of executive compensation. CHX'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.

CHX'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 CHX-listed companies are better informed about potential conflicts when selecting and receiving advice from advisers. Similarly, the provisions of CHX'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, SR-CHX-2012-13, as amended, is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Exchange Act.<sup>109</sup>

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>110</sup> that the proposed rule change, SR-CHX-2012-13, as amended, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>111</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68665; File No. SR-BYX-2013-001]

### Self-Regulatory Organizations; BATS Y-Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Fees for Use of BATS Y-Exchange, Inc.

January 16, 2013.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the

"Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 2, 2013, BATS Y-Exchange, Inc. (the "Exchange" or "BYX") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange has designated the proposed rule change as one establishing or changing a member due, fee, or other charge imposed by the Exchange under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<sup>4</sup> which renders the proposed rule change effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The Exchange proposes to amend the fee schedule applicable to Members<sup>5</sup> and non-members of the Exchange pursuant to BYX Rules 15.1(a) and (c). Changes to the fee schedule pursuant to this proposal will be effective upon filing.

The text of the proposed rule change is available at the Exchange's Web site at <http://www.batstrading.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The Exchange proposes to modify its fee schedule effective January 2, 2013,

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

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

<sup>5</sup> A Member is any registered broker or dealer that has been admitted to membership in the Exchange.

<sup>109</sup> 15 U.S.C. 78f(b)(5).

<sup>110</sup> 15 U.S.C. 78s(b)(2).

<sup>111</sup> 17 CFR 200.30-3(a)(12).