

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-2012-111 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-2012-111. 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 offices 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-NASDAQ-2012-111, and should be submitted on or before November 6, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>9</sup>

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

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-68033; File No. SR-CHX-2012-13]

**Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change, as Modified by Amendments Nos. 1 and 2, To Establish Listing Standards for Issuers' Compensation Committees**

October 10, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on September 26, 2012, the Chicago Stock Exchange, Inc. ("CHX" or the "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which filing was amended and replaced in its entirety by Amendment No. 2 thereto on October 10, 2012, which Items have been prepared by the Exchange.<sup>3</sup> 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 Article 22, Rule 2 (Admittance to Listing), Rule 4 (Removal of Securities) and Rule 19 (Corporate Governance) to comport with Section 10(C) of the Exchange Act<sup>4</sup> and Rule 10C-1<sup>5</sup> thereunder that directs the Exchange to establish listing standards, among other things, that require each member of a listed issuer's compensation committee to be an independent member of its board of directors and relating to compensation committees and their use of compensation consultants, independent legal counsel and other advisers (collectively, "compensation advisers"). The text of this proposed rule change is available on the Exchange's Web site at ([www.chx.com](http://www.chx.com)) and in the Commission's Public Reference Room.

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

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

<sup>3</sup> The Commission notes that Amendment No. 1 was submitted on October 2, 2012 to indicate that the Board of Directors had approved the proposal.

<sup>4</sup> 15 U.S.C. 78j-3.

<sup>5</sup> 17 CFR 240.10C-1.

**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 CHX included statements concerning the purpose of and basis for the proposed rule changes and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The CHX has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

1. Purpose

This Amendment No. 2 to SR-CHX-2012-13 (the "filing") amends and replaces in its entirety the Filing as originally submitted on September 26, 2012. Amendment No. 2 corrects several technical errors under this Rule 19b-4 form, Exhibit 1 and Exhibit 5. Moreover, substantive amendments were made to the Exhibit 5 and corresponding amendments were also made to this Exhibit 1 and 19b-4 form. Item 2 of this 19b-4 filing has been amended to indicate that this proposal was approved by the Exchange's Board of Directors on September 27, 2012.<sup>6</sup> Proposed Rule 19(d)(1) was amended to require issuers to have a compensation committee composed entirely of independent directors, subject to the general independence requirements of proposed Rule 19(p)(3)(A) and additional specific requirements for compensation committees under proposed Rule 19(p)(3)(B). Moreover, proposed Rule 19(d)(1) was amended to define "compensation committee" as independent directors functioning within either formal committees of the board of directors or a non-committee group. Proposed Rule 19(d)(2) was amended to include a charter requirement for compensation committees and removes the definition of "compensation committee" and "functional equivalent," which has been restated under proposed Rule 19(d)(1)(A)-(C). The exceptions under proposed Rule 19(d)(5)(B) were amended to be numerically consistent with proposed paragraph .03 of the Interpretations and Policies of Rule 19. Proposed Rule 19(d)(5)(B)(iii) was amended to narrow the scope of the passive business organizations

<sup>6</sup> The Commission notes that this change was filed as Amendment No. 1. See *supra* note 3.

<sup>9</sup> 17 CFR 200.30-3(a)(12).

exemption. Proposed Rule 19(d)(5)(B)(iv) was amended to include a phase-in period for foreign issuers who no longer qualify as such. Proposed Rule 19(d)(5)(C) was amended to solely refer to the smaller reporting companies exemption and includes a phase-in period for issuers that no longer qualify as such. Proposed Rule 19(p)(3) was amended to reorganize the bright line tests for independent directors and to allow the inclusion of proposed paragraph (B), which outlines additional independent director requirements specific to compensation committee membership. Proposed Rule 19(p)(5) was amended to make the terms “small business issuer” and “smaller reporting company” interchangeable for the purposes of CHX rules. Proposed paragraph .03 of the Interpretations and Policies of Rule 19 was amended to remove a listed exemption for small business issuers. Finally, proposed paragraph .05(6) of the Interpretations and Policies of Rule 19 outlines an amended transition period for compliance with the proposed listing standards.

The Exchange proposes to amend Article 22, Rule 2 (Admittance to Listing), Rule 4 (Removal of Securities) and Rule 19 (Corporate Governance) to comport with Section 10(C) of the Exchange Act<sup>7</sup> and Rule 10C-1<sup>8</sup> thereunder, which directs the Exchange to establish listing standards that require each member of a listed issuer’s compensation committee to be an independent member of its board of directors and listing standards relating to compensation committees and their use of compensation advisers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) established Section 10C of the Exchange Act, which directed the Securities and Exchange Commission (“Commission” or “SEC”) to require national securities exchanges and associations to prohibit the listing of any equity security of an issuer that is not in compliance with Section 10C’s compensation committee and compensation adviser requirements.<sup>9</sup> Specifically, section 10C(a)(1) of the Exchange Act required the Commission to adopt rules directing the exchanges to establish listing standards that require each member of a listed issuer’s compensation committee to be a member of the board of directors and to be “independent.”<sup>10</sup> Moreover, Section

10C(a)(4)<sup>11</sup> of the Exchange Act required the Commission to permit the exchanges to exempt particular relationships from the independence requirements, as each exchange determines is appropriate, taking into consideration the size of an issuer and any other relevant factors and section 10C(f)(3)<sup>12</sup> required the Commission to permit the exchanges to exempt categories of issuers from the requirements of section 10C, as each exchange determines is appropriate, taking into consideration of the impact of section 10C on smaller reporting issuers. In addition, Section 10C(f)<sup>13</sup> of the Exchange Act required the Commission to adopt rules directing the exchanges to establish listing standards that provide for requirements relating to compensation committees and compensation consultants, independent legal counsel and other advisers (collectively, “compensation advisers”), as set forth in paragraphs (b)–(e) of Section 10C. Finally, Section 10C(c)(2) required each issuer to disclose in any proxy or consent solicitation material for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting), in accordance with Commission regulations, whether the issuer’s compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed.<sup>14</sup>

On June 27, 2012, the Commission promulgated Exchange Act Rule 10C-1 to implement the compensation committee listing requirements of Sections 10C of the Exchange Act. As such, the Exchange now proposes to amend its rules to comport with the new requirements.

#### Proposed Amendments to CHX Article 22

The Exchange proposes to amend portions of Article 22, Rule 2 (Admittance to Listing), Rule 4 (Removal of Securities) and Rule 19 (Corporate Governance) to establish listing standards that require each member of a listed issuer’s compensation committee to be an “independent” member of its board of directors, to adopt standards relating to compensation committees’ authority to use compensation advisers and to clarify the consequences to issuers for failure to comply with these proposed

amendments. It is important to note that virtually all of the proposed amendments are in Rule 19(d), which currently outlines all of the listing standards with respect to issuers’ compensation committees.

#### Proposed Rule 2 and Rule 4(a)

Proposed Rule 2 provides that the Exchange’s Board of Governors may list securities once the requirements of Article 22 are met and upon terms, conditions and payment of fees as the Exchange’s board of directors may from time to time prescribe. In doing so, proposed Rule 2 adopts much of the current Rule 2, while only clarifying that the Board of Governors may only admit securities “once the requirements of this Article are met.” Also, proposed Rule 4(a) provides that securities may be removed from the list, with notice, by either the issuer or the Exchange, for any reason, including an issuer’s failure to comply with the listing standards of this Article 22. In doing so, proposed Rule 4(a) adopts much of the current Rule 4(a), while inserting language that states that securities may be delisted by either the issuer or the Exchange and clarifies that securities may be removed for any reason, including an issuer’s failure to comply with the requirements of this Article, which includes proposed Rule 19(d). Current Rule 4(b)–(g) establish the procedures under which a security may be delisted, to which the Exchange proposes no amendments.

As such, proposed Rule 2 and Rule 4, considered in conjunction with current Article 22, Rule 1<sup>15</sup>, comport with Exchange Act Rule 10C-1(a)(1) that requires the Exchange to “prohibit the *initial and continued* listing of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.” That is, the purpose of these proposed amendments is to clarify the potential consequences of an issuer’s failure to comply with CHX Article 22, which includes the proposed compensation committee listing standards.

#### Proposed Rule 19(d)(1) and 19(p)(3)

Proposed Rule 19(d)(1)<sup>16</sup> states that an issuers must have a “compensation

<sup>15</sup> CHX Article 22, Rule 1 states, in pertinent part, that “the requirements, set forth in this Article, must be met in order for the Exchange to entertain an application for listing.”

<sup>16</sup> In order to implement proposed Rule 19(d)(1), the Exchange proposes to delete current Rule 19(d)(1), which outlines how the compensation of a chief executive officer is to be determined and current Rule 19(d)(2), which outlines how a the compensation of other officers are to be determined,

<sup>7</sup> *Supra* note 4.

<sup>8</sup> *Supra* note 5.

<sup>9</sup> 15 U.S.C. 78j-3.

<sup>10</sup> 15 U.S.C. 78j-3(a).

<sup>11</sup> 15 U.S.C. 78j-3(a)(4).

<sup>12</sup> 15 U.S.C. 78j-3(f)(3)(A).

<sup>13</sup> 15 U.S.C. 78j-3(f).

<sup>14</sup> 15 U.S.C. 78j-3(c)(2).

committee” composed entirely of “independent directors,” as defined under proposed Rule 19(p)(3) and that also meet the additional independence requirements specific to compensation committees, under proposed Rule 19(p)(3)(B). The proposed rule continues to define “compensation committee” as: (A) a committee of the board of directors that is designated as the compensation committee; (B) in the absence of a committee of the board of directors that is designated as the compensation committee, a committee of the board of directors performing functions typically performed by a compensation committee, including oversight of the executive compensation, even if it is not designated as the compensation committee or also performs other functions; or (C) in the absence of one of the aforementioned committees, the members of the board of directors who oversee executive compensation matters on behalf of the board of directors, who together must comprise a majority of the board’s independent directors.

In turn, proposed Rule 19(p)(3) defines “independent director” as a person who is a member of the issuer’s board of directors, other than an officer or employee of the issuer or its subsidiaries or any other individual having a relationship, which, in the opinion of the issuer’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of an independent director and places the affirmative duty of making such a determination on the board of directors. Furthermore, proposed Rule 19(p)(3)(A) provides that a director may not be deemed to be independent if such director has a relationship with the issuer which violates any one of seven “bright line” tests.<sup>17</sup> Proposed Rule

and restate those rules with amendments, as proposed Rule 19(d)(4), which is discussed below.

<sup>17</sup>Proposed Rule 19(p)(3)(A)(i)–(vii) virtually adopts current Rule 19(p)(3)(A)–(G) and provides that the following persons shall not be considered independent: (i) A director who is, or during the past three years, was employed by the issuer or its parent or subsidiary; (ii) a director or an immediately family member of a director who had accepted payments from the issuer or its parent or subsidiary in excess of \$120,000 in the current fiscal year or any of the past three fiscal years, with exceptions for payments received for services to the board, payments arising from investments in the issuer’s securities, compensation paid to an immediate family member who is an employee, but not an executive officer, of the issuer, benefits under a tax-qualified retirement plan, non-discretionary compensation or loans permitted under Section 13(k) of the Exchange Act; (iii) a director who is an immediate family member of an individual who is, or at any time during the past three years was, employed by the issuer or by any parent or subsidiary of the issuer as an executive

19(p)(3)(B) establishes additional independent director requirements specific to compensation committees that states that in affirmatively determining the independence of any director who will serve on the compensation committee of the issuer’s board of directors, the board must 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, two factors. First, (i) the board must consider the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the issuer to such director. Proposed subparagraph (i) explains that this factor requires that when considering the sources of a director’s compensation, the board should consider whether the director receives compensation from any person or entity that would impair her ability to make independent judgments about the issuer’s executive compensation. Second, (ii) the board must consider whether such director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer. The proposed subparagraph (ii) explains that this factor requires that when considering such affiliate relationships in determining her independence for purposes of compensation committee service, the board should consider whether the affiliate relationship places the director under the direct or indirect control of the issuer or its senior management, or creates a direct

officer; (iv) a director who is, or has an immediate family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the issuer made, or from which the issuer received, payments for property or services, in the current or any of the past three fiscal years, that exceed 5% of the recipient’s consolidated gross revenues for that year, or \$200,000, whichever is more, other than payments arising solely from investments in the issuer’s securities or payments under non-discretionary charitable contribution matching programs; (v) a director of the issuer who is, or has an immediate family member who is, employed as an executive officer of another entity where, at any time during the past three years, any of the executive officers of the issuer served on the compensation committee of such other entity; (vi) A director who is, or has an immediate family member who is, a current partner of the issuer’s outside auditor, or who has a partner or employee of the issuer’s outside auditor who worked on the issuer’s audit at any time during the past three years; (vii) In the case of an investment company, in lieu of paragraphs (i)–(vi), a director who is an “interested person” of the company as defined in section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee.

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.

As such, proposed Rule 19(d)(1) and Rule 19(p)(3) comport with the requirements of Exchange Act Rule 10C–1(b)(1)(i) and (ii). Initially, as mandated by Exchange Act Rule 10C–1(b)(1)(i), which states, “each member of a compensation committee must be a member of the board of directors of the listed issuer, and must otherwise be independent,” proposed Rule 19(d)(1) requires members of an issuer’s compensation committee be “independent directors” and, in turn, proposed Rule 19(p)(3) defines a “director,” in relevant part, as a “person who is member of the issuer’s board of directors.” Additionally, the Exchange proposes to require issuers to have a compensation committee, similar to Section 303A.05 of the NYSE Listed Company Manual.<sup>18</sup> The Exchange submits that its proposed definition of “compensation committee,” which adopts Exchange Act Rule 10C–1(c)(2)<sup>19</sup> almost verbatim, does not require issuers to do anything more than what they are already required to do, which is to have either “a majority of the independent directors or a compensation committee comprised solely of independent directors” determine or recommend executive compensation.<sup>20</sup>

Moreover, proposed Rule 19(p)(3) comports with Exchange Act Rule 10C–1(b)(1)(ii). Specifically, Exchange Act Rule 10C–1(b)(1)(ii)(A) requires the Exchange to consider “the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory or other compensatory fee paid by the issuer to such a member of the board of directors,” whereas Exchange Act Rule 10C–1(b)(1)(ii)(B) requires the Exchange to consider “whether a member of the board of directors of an issuer is affiliated with the issuer,<sup>21</sup> a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.” The Exchange

<sup>18</sup> Section 303A.05 of the NYSE Listed Company Manual states, “listed companies must have a compensation committee composed entirely of independent directors.”

<sup>19</sup> 17 CFR 240.10C–1(c)(2).

<sup>20</sup> CHX Article 22, Rule 19(d)(1) and Rule 19(d)(2).

<sup>21</sup> The Exchange understands “affiliated with issuer” to have a similar meaning as “affiliated with a specified person” defined under Exchange Act Rule 12b–2 [17 CFR 240.12b02 [sic] as “a person that directly, or indirectly through one more intermediaries, controls, or is controlled by, or is under common control with, the person specified.”

submits that Exchange Act Rule 10C-1(b)(1)(ii) is largely already addressed via proposed Rule 19(p)(3)(A)(i)-(vii)<sup>22</sup> and is fully incorporated through proposed Rule 19(p)(3)(B).

Proposed Rule 19(p)(3)(A)(i) precludes from being considered independent a director who currently is or was, during the past three years, employed by the issuer or parent or subsidiary of the issuer. This preclusion is based, in part, on Exchange Act Rule 16b-3(b)(3)(i),<sup>23</sup> which excludes from the definition of a “non-employee director” a director who is an officer of the issuer or a parent or subsidiary of the issuer, or otherwise currently employed by the issuer or a parent or subsidiary of the issuer. The Exchange submits that a director who is or was an executive officer or employee of the issuer should not be considered independent due to the nature of the professional relationships that are formed in an employment setting and the consequences therefrom. For example, a director who is employed by the issuer may have her employee compensation (*i.e.* salary, bonuses, etc. \* \* \*) affected by her actions as a member of the compensation committee. Moreover, a director who recently ended her employment with the issuer may still maintain personal relationships with executive officers that may compromise independent judgment. Consequently, the look-back provision is necessary, because the nature of such personal relationships may remain unchanged for sometime after the director ceased being employed by the issuer.

Proposed Rule 19(p)(3)(A)(ii) precludes from being considered independent a director who had or an immediate family member of the director who had accepted payments from the issuer or parent or subsidiary of the issuer in excess of \$120,000 in the current fiscal year or any of the past three fiscal years, excluding (1) compensation for board or board committee service; (2) payments arising solely from investments in the issuer’s securities; (3) compensation paid to an immediate family member who is a non-executive employee of the issuer or a parent or subsidiary of the issuer; (4) benefits under a tax-qualified retirement plan; (5) non-discretionary compensation; or (6) loans permitted under Section 13(k) of the Act. The only difference between proposed Rule

19(p)(3)(A)(ii) and current Rule 19(p)(3)(B) is the proposal to increase the cap amount from \$60,000 to \$120,000, so as to remain in lockstep with other exchanges, such as BATS<sup>24</sup> and disclosure guidelines under Item 404(a) of Regulation S-K,<sup>25</sup> both of which set threshold amounts at \$120,000.

Similar to subparagraph (i), proposed subparagraph (ii) is also based in part on Exchange Act Rule 16b-3(b)(3)(i), which excludes from the definition of “non-employee director,” a director who receives compensation, either directly or indirectly, from the issuer or a parent or subsidiary of the issuer for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed \$120,000, pursuant to Item 404(a) of Regulation S-K.<sup>26</sup> The Exchange acknowledges that a director who meets the definition of a “non-employee director” is not necessarily “independent.” However, the Exchange submits that a cap of \$120,000 on affected payments are adequately high to allow a director or immediate family member to receive payments for permissible services to the issuer, while sufficiently low as to not preclude director independence. Moreover, a cap on such payments is preferable to an absolute rule that precludes director independence for any payments made. This is because the category of services contemplated by this subparagraph (ii), such as consulting services, are inherently independent from the ordinary business function of the issuer, in contrast to payments received in the context of employment. Given these considerations, the Exchange submits that payments that arise from independent permissible services should not *per se* disqualify a director from being considered independent.

<sup>24</sup> BATS Rule 14.10(c)(1)(B) states, in pertinent part, that an “independent director” means a person other than an Executive Officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director” and paragraph (c)(1)(B)(ii) precludes from being considered independent “a director who accepted or who has a Family Member who accepted any compensation from the Company in excess of \$120,000 during any period of twelve consecutive months within the three years preceding the determination of independence.”

<sup>25</sup> 17 CFR 229.404.

<sup>26</sup> Item 404(a) of Regulation S-K [17 CFR 229.404] mandates disclosure requirements for transactions exceeding \$120,000 in which the registrant was a participant and in which any “related person” has a direct or indirect material interest. In the context of Item 404(a), a “related person” includes any director of the registrant.

Moreover, due to the intimate nature of the relationship between a director and an immediate family member,<sup>27</sup> the Exchange submits that immediate family members of a director that fall under the purview of subparagraph (ii) should also preclude such a director from being considered independent. For the same reason, the Exchange has also included a director’s relationship to such immediate family members within the purview of paragraphs (iii)-(vi). With respect to the six categories of payments that excluded [sic] from the cap requirement of this subparagraph (B), the Exchange submits that such exceptions are appropriate because those payments are nondiscretionary and/or predetermined payments. As such, these payments are immaterial to a director’s ability to be independent, where it is unlikely that these payments could be unilaterally altered by any executive officer, at least without the knowledge of the board of directors.

Proposed Rule 19(p)(3)(A)(iii) precludes a director who is an immediate family member of an individual who currently is or was, during the past three years, employed as an executive officer of the issuer or parent or subsidiary of the issuer. Given the intimate nature of the relationship between immediate family members, the Exchange submits that where a director’s immediate family member is an executive officer of the issuer, the director is *per se* not independent. This is because the nature of the personal relationship between the director and immediate family member who is an executive officer will likely compromise independent judgment, especially in the context of determining the compensation of the immediate family member. It is important to note that although this paragraph does not include immediate family members who are non-executive employees of the issuer, Rule 19(p)(3) still allows for a board of directors to nonetheless find that such a relationship would preclude a director from being independent. However, the Exchange submits that establishing an absolute rule would be inappropriate and that an issuer’s boards of directors is better equipped to assess such relationships on a case by case basis.

Proposed Rule 19(p)(3)(A)(iv) precludes from being independent a director who is or has an immediate family member who is a partner in or a

<sup>27</sup> Pursuant to CHX Rule 19(p)(2), an “immediate family member” includes a person’s spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law and any person who has the same residence.

<sup>22</sup> As mentioned above, *supra* note 16, proposed Rule 19(p)(3)(A)(i)-(vii) virtually mirrors current Rule 19(p)(3)(A)-(G), but for a few minor substantive amendments, that are discussed below.

<sup>23</sup> 17 CFR 240.16b-3(b)(3)(i).

controlling shareholder or an executive officer of any organization to which the issuer made or from which received payments for property or services, in the current or any of the past three fiscal years, that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, excluding payments arising (1) solely from investments in the issuer's securities or (2) payment under non-discretionary charitable contribution matching programs. The purpose of this rule is to scrutinize directors who benefit from their business activities with the issuer when determining their ability to exercise independent judgment. Similar to subparagraph (ii), the Exchange submits that placing a cap on value of property or services received or given is preferable to a rule that precludes director independence for any such activity. This is because the nature of corporate governance is as such that directors are frequently affiliated with multiple corporate entities in the same or related fields and inevitably, these various entities deal with each other in the ordinary course of their respective businesses. Thus, the Exchange submits that so long as such activities do not exceed 5% of the payment recipient's consolidated gross revenues for that year or \$200,000, whichever is more, the activity is ordinary enough so as to not preclude director independence. In addition, the exclusions to this paragraph are necessary so as to exclude categories of payments that are non-discretionary and pre-determined, therefore immaterial to the independence assessment.

Proposed Rule 19(p)(3)(A)(v) precludes from being independent a director who is or has an immediate family member who is employed as an executive officer of another entity where, at any time during the past three years, any of the executive officers of the issuer served on the compensation committee of the other entity. The Exchange submits that a director cannot be independent where the director is charged with determining the compensation of an executive, who in turn, is charged with determining the director's compensation in her capacity as an executive officer of the other entity. This scenario is obviously improper, as it may open the door to, among other things, undue influence and breaches of fiduciary duty. Certainly, a director subjected to such forces would not be able to exercise independent judgment. Also, given the personal nature of family relationships, directors who have immediate family members who are employed as

executive officers by the aforementioned other entity should also be disqualified from being considered independent.

Proposed Rule 19(p)(3)(A)(vi) precludes from being independent a director (1) who is or has an immediate family member who is a current partner of the issuer's outside auditor or (2) who was a partner or employee of the issuer's outside auditor who worked on the issuer's audit at any time during the past three years. The primary purpose of this subparagraph is to prevent a director, who has or had a direct association with the issuer's outside auditor, from being placed on the issuer's audit committee.

Proposed Rule 19(p)(3)(A)(vii) applies to investment companies in lieu of subparagraphs (i)-(vi) and precludes from being independent a director who is an "interested person," as that term is defined under section 2(a)(19) of the Investment Company Act of 1940 ("Investment Company Act").<sup>28</sup> The Exchange proposes to maintain the exemption of open-ended and closed-ended investment companies, as those terms are defined under section 4 and 5(a) of the Investment Company Act,<sup>29</sup> from the compensation committee requirements of this proposed Rule 19(d). The exemptions are discussed in detail below through proposed Rule 19(d)(5)(B)(ii).

Moreover, proposed Rule 19(p)(3)(B) comports with Exchange Act Rule 10C-1(b)(ii) by requiring an issuer's board of directors 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 two factors explicitly enumerated in Rule 10C-1(b)(ii). When considering the sources of a director's compensation in determining her independence for purposes of compensation committee service, proposed Rule 19(p)(3)(B)(i) states the board should consider whether the director receives compensation from any person or entity that would impair her ability to make independent judgments about the issuer's executive compensation. Similarly, when considering any

affiliate relationship a director has with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer, in determining her independence for purposes of compensation committee service, the proposed Rule 19(p)(3)(B)(ii) provides that the board should consider whether the affiliate relationship places the director under the direct or indirect control of the issuer 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.

However, the Exchange does not propose to adopt 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. In particular, the Exchange does 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. In the adopting release for Rule 10C-1 ("adopting release"),<sup>30</sup> the SEC recognized that the exchange might determine that not all affiliate relationships would adversely affect a director's ability to be independent from management.<sup>31</sup> Consistent with the view of commentators on the SEC's rules as originally proposed, the Exchange believes that, rather than adversely affecting a director's ability to be independent from management as a compensation committee member, share ownership in the issuer aligns the director's interest with those of unaffiliated shareholders, as their stock ownership gives then the same economic interest in ensuring that the issuer's executive compensation is not excessive.

In sum, the Exchange believes that its existing "bright line" independence standards as set forth in proposed Rule 19(p)(3)(A) and the additional independence requirement as set forth in proposed 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. In addition, there is language in current Rule 19(p)(3), adopted in proposed Rule 19(p)(3) that already requires the board to consider

<sup>28</sup> 15 USCS [sic] 80a-2(a)(19).

<sup>29</sup> Pursuant to Section 4 and 5(a)(1) of the Investment Company Act [15 USCS [sic] 80a-4 and 80a-5(a)(1)], an "open-end company" means a management company, other than a unit investment trust or face-amount certificate company, which is offering for sale or has outstanding any redeemable security of which it is the issuer. Pursuant to section 5(a)(2) [15 USCS 80a-5(a)], a "closed-end company" means any management company other than an open-end company.

<sup>30</sup> See Listing Standards for Compensation Committees, Release No. 33-9330 (June 27, 2012) [17 CFR Parts 229 and 240].

<sup>31</sup> See Adopting Release at 24.

any other material relationships between the director and the issuer or its management that are not subject of “bright line” tests in proposed Rule 19(p)(3)(A). The Exchange believes that these requirements with respect to general director independence, when combined with the additional requirements of proposed Rule 19(p)(3)(B), represent an appropriate standard for compensation committee independence that is consistent with the requirements of Exchange Act Rule 10C–1.

#### Proposed Rule 19(d)(2)

Proposed Rule 19(d)(2) establishes a formal written charter or board resolution requirement for all issuers, with respect to compensation committees. Specifically, the proposed rule states that each issuer must adopt a formal written charter or board resolution, as applicable, addressing at minimum (A) the scope of the compensation committee’s responsibilities and how it carries out those responsibilities, including structure, process and membership requirements; (B) the compensation committee’s responsibility for determining or recommending to the board for determination, the compensation of the chief executive officer and all other officers of the issuer as set forth in proposed Rule 19(d)(3); and (C) the specific compensation committee responsibilities and authority set forth in proposed Rule 19(d)(4).

The Exchange submits that requiring issuers to adopt such a charter or board resolution is necessary to facilitate compliance with the proposed amendments to the compensation committee listing standards. Moreover, the proposed rule is consistent with other CHX corporate governance rules requiring a written charter or board resolution<sup>32</sup> and is also modeled on proposed NASDAQ Rule 5065(d)(1).<sup>33</sup>

<sup>32</sup> Proposed Rule 19(d)(3) is modeled on CHX Article 22, Rule 19(c)(2), which requires each issuer to adopt a formal written charter or board resolution, as applicable, addressing the nominations process and any related matters as may be required under federal securities law.

<sup>33</sup> Proposed NASDAQ Rule 5065(d)(1) states, “each Company must certify that it has adopted a formal written compensation committee charter and that the compensation committee will review and reassess the adequacy of the formal written charter on an annual basis. The charter must specify: (A) The scope of the compensation committee’s responsibilities, and how it carries out those responsibilities, including structure, process and membership requirements; (B) the compensation committee’s responsibility for determining or recommending to the board for determination, the compensation of the chief executive officer and all other Executive Officers of the Company; (C) that the chief executive officer may not be present during voting or deliberations on his or her

#### Proposed Rule 19(d)(3)

Proposed Rule 19(d)(3) is a consolidated restatement of current Rule 19(d)(1) and 19(d)(2). In doing so, current Rule 19(d)(3)(A) has been deleted and restated as proposed Rule 19(d)(5)(A)(i), with some syntax amendments to improve logical flow and organization and current Rule 19(d)(3)(B) has been deleted and restated under proposed Rule 19(d)(5)(B)(i). Specifically, proposed Rule 19(d)(3) states that the function of a compensation committee or functional equivalent is to determine or recommend to the issuer’s board of directors for determination the compensation of issuer’s chief executive officer and other officers. It continues that the chief executive officer shall not be present during the deliberations regarding her own compensation, but that the chief executive officer may be present during deliberations regarding compensation of other officers, but may not vote. Aside from syntax, the only difference between this proposed rule and current Rule 19(d)(1) and Rule 19(d)(2) is that the proposed rule omits the portions of the current rules that mention that compensation of executive officers shall be determined or recommended to the board “either by (A) a majority of the issuer’s independent directors or (B) a compensation committee comprised solely of independent directors.”<sup>34</sup> The reason for this omission is that “compensation committee” and “majority of the issuer’s independent directors” have been combined and defined under proposed Rule 19(d)(1) as “compensation committee.” The Exchange submits that this organizational amendment is necessary for the logical flow of the proposed Rule 19(d).

#### Proposed Rule 19(d)(4)

Proposed Rule 19(d)(4)(A)–(E) outlines listing standards mandated

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

<sup>34</sup> Currently, CHX Article 22, Rule 19(d)(1) states “compensation of the issuer’s chief executive officer shall be determined, or recommended to the board for determination, either by (A) a majority of the independent directors or (B) a compensation committee comprised solely of independent directors. The chief executive officer may not be present during voting or deliberations” and Rule 19(d)(2) states “compensation of the issuer’s other officers, as that term is defined in Section 16 of the Act, shall be determined, or recommended to the board for determination, either by (A) a majority of the issuer’s independent directors or (B) a compensation committee comprised solely of independent directors. The chief executive officer may be present during deliberations regarding compensation of other officers, but may not vote.”

under Exchange Act Rule 10C–1(b)(2), concerning the authority of compensation committees to retain compensation consultants, outside legal counsel and other advisers (collectively “compensation advisers”).

Specifically, pursuant to Exchange Act Rule 10C–1(b)(2)(i), proposed subparagraph (A) provides that a compensation committee may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser. Also, pursuant to Exchange Act Rule 10C–1(c)(2)(iii), proposed subparagraph (A) continues by stating that it shall not apply to issuers that do not maintain a formal committee of the board of directors for determining executive compensation. 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.<sup>35</sup>

Also, pursuant to Exchange Act Rule 10C–1(b)(2)(ii), proposed subparagraph (B) provides that the compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel and other adviser retained by the compensation committee. Furthermore, pursuant to Exchange Act Rule 10C–1(b)(2)(iii), proposed subparagraph (C) states that nothing in this proposed Rule 19(d)(3) shall be construed to require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel or other adviser nor to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of its duties.

Moreover, pursuant to Exchange Act Rule 10C–1(b)(3), proposed subparagraph (D) states that an issuer that maintains a compensation committee shall provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to a compensation consultant, independent legal counsel or any other adviser retained by the compensation committee. Similar to proposed

<sup>35</sup> See Listing Standards for Compensation Committees, Release No. 33–9330 (June 27, 2012) [17 CFR Parts 229 and 240], at p. 12.

subparagraph (A), pursuant to Exchange Act Rule 10C-1(c)(2)(iii), proposed subparagraph (D) continues by stating that it shall not apply to issuers that do not maintain a formal committee of the board of directors, pursuant to Exchange Act Rule 10C-1(c)(2)(iii).<sup>36</sup>

Finally, pursuant to Exchange Act Rule 10C-1(b)(4), proposed subparagraph (E) states that the compensation committee may select a compensation consultant, legal counsel or other adviser, other than in-house legal counsel, only after taking into consideration the following six factors: (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, or other adviser or the person employing the adviser with an executive officer of the issuer. The Exchange agrees with the Commission that these six factors, when considered together, are competitively neutral, as they 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>37</sup> Therefore, the Exchange proposes to add no further requirements or factors to be considered under this subparagraph (E).

Proposed Rule 19(d)(5), Rule 19(p)(5) and Paragraph .03 of the Interpretations and Policies of Rule 19

Proposed Rule 19(d)(5) outlines exceptions to the listing standards of this proposed Rule 19(d), pursuant to

Exchange Act Rule 10C-1(b)(1)(iii), which exempts specified categories of issuers and gives the Exchange discretion to exempt certain director relationships from the requirements of Rule 10C-1(b)(1) and Rule 10C-1(b)(5), which gives the Exchange discretion to exempt from the requirements of Exchange Act Rule 10C-1 any category of issuer, after considering relevant factors. In establishing these exemptions, proposed Rule 19(d)(5) distinguishes between (A) *temporary exemptions*, (B) *general exemptions* and a (C) *limited exemption for smaller reporting companies*.

Proposed Rule 19(d)(5) lists the *temporary exemptions* from proposed Rule 19(d). Proposed Rule 19(d)(5)(A)(i) is a restatement of current Rule 19(d)(3), which allows an issuer, under exceptional and limited circumstances, to temporarily appoint a non-independent director to its compensation or functional equivalent one director who is not independent, for a term that shall not exceed two years from the date of appointment (unless the director becomes independent prior to the end of the two year period), if (1) the compensation committee or functional equivalent is comprised of at least three persons, including the proposed non-independent director; (2) the non-independent director is not a current officer or employee nor is an immediate family member of a current officer or employee; and (3) the issuer's board of directors determines that (a) the membership of the non-independent director on the compensation committee or functional equivalent is required by the best interests of the company and its shareholders and (b) the board discloses, in the proxy statement for the next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination.

The purpose of this exemption is to 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 doing so, the exemption clearly establishes guidelines to minimize the risk of abuse by requiring that the non-independent director's appointment be temporary, that such a director will not be an employee of the issuer and that such a director's appointment is made clear to the shareholders via a proxy statement or Form 10-K or 20-F. Furthermore, the Exchange submits that it would not be in the public interest to burden issuers confronted with unforeseen and exceptional

circumstances, especially where inaction by a compensation committee may result in a loss of executive talent to the detriment of shareholders. It is important to note that the same temporary exemption, with some differences for context, can be found in CHX Article 22, Rule 19(b)(1)(C)(i)<sup>38</sup> and given the similarities between that rule for audit committees and this proposed rule for compensation committees, the Exchange submits that this exemption is wholly appropriate and necessary.

In addition, proposed Rule 19(d)(5)(A)(ii) outlines an opportunity to cure defects, almost precisely as stated in Exchange Act Rule 10C-1(a)(3) and current CHX Article 22, Rule 19(b)(1)(C)(ii).<sup>39</sup> Specifically, it states that 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, with prompt notice by the issuer to the Exchange, 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 be no longer an independent director.

Proposed Rule 19(d)(5)(B)(i)-(viii) list the *general exemptions* from proposed Rule 19(d). All of the exemptions listed under this subparagraph are (1) specific

<sup>38</sup> CHX Article 22, Rule 19(b) governs listing standards for "audit committees" and Rule 19(b)(1)(C)(i) states "one director who is not independent as required by section (b)(1)(A)(i) above, but who meets the criteria set forth in SEC Rule 10A-3 and who is not a current officer or employee (or an immediate family member of a current officer or employee) may be appointed to the audit committee, if the issuer's board under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the board discloses, in the proxy statement for the next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K, 20-F or other applicable annual disclosure filed with the SEC), the nature of the relationship and the reasons for that determination. A member appointed under this exception may not serve on the audit committee for more than two years under this exception (unless he or she ultimately satisfies the definition of an independent director) and may not chair the audit committee."

<sup>39</sup> CHX Article 22, Rule 19(b) governs listing standards for "audit committees" and Rule 19(b)(1)(C)(ii) and Rule 19(b)(1)(C)(i) states "if a member of an audit committee ceases to meet the independence criteria set forth in SEC Rule 10A-3 for reasons outside the person's reasonable control, that person may remain a member of the committee until the earlier of the next annual shareholders' meeting or one year from the occurrence of the event that caused the member to no longer meet the independence criteria. The issuer must promptly notify the Exchange if this circumstance occurs."

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

<sup>37</sup> See Listing Standards for Compensation Committees, Release No. 33-9330 (June 27, 2012) [17 CFR Parts 229 and 240], at p. 40.

exemptions required under Exchange Act Rule 10C-1(b)(5); (2) proposed expansions of specific exemptions listed under Exchange Act Rule 10C-1(b)(1)(iii); or (3) exemptions already in effect under CHX Rules and proposed pursuant to Exchange Act Rule 10C-1(b)(5)(i). Some of the proposed exemptions fall under one or more of these categories and each exemption will be discussed in this context.

Proposed subparagraph (i) exempts limited partnerships and companies in bankruptcy from the requirements of proposed Rule 19(d). Such issuers are already exempt from the current compensation committee requirements under paragraph .03(1) of the Interpretations and Policies of Rule 19.<sup>40</sup> Although Exchange Act Rule 10C-1(b)(1)(iii)(A)(1) and (2) already mandate that such companies be exempt from the independence requirements, subparagraph (ii) proposes to expand that exemption to all requirements under Exchange Act Rule 10C-1, pursuant to the Exchange's authority granted under Exchange Act Rule 10C-1(b)(5)(i). A "limited partnership" is defined as a form of business ownership and association consisting of one or more general partners who are fully liable for the debts and obligations of the partnership and one or more limited partners whose liability is limited to the amount invested.<sup>41</sup> As such, limited partnerships are already exempt from the current compensation committee requirements because the ownership/management structure of limited partnerships renders the independent director requirements inapplicable. The Exchange submits that this same reasoning renders the compensation adviser requirements unnecessary as well. With respect to companies in bankruptcy, the purpose behind this exemption is to not overburden issuers that are struggling to emerge from bankruptcy. That is, it would not be in public interest to burden such companies with additional listing standards where such companies are subject to a host of bankruptcy requirements that will fundamentally impact its survival. Given these considerations, the Exchange submits that it would be wholly appropriate to exempt limited partnerships and companies in bankruptcy from all of the requirements of proposed Rule 19(d).

Proposed subparagraph (ii) exempts from the requirements of proposed Rule

19(d) "closed-end and open-end management companies" registered under the Investment Company Act,<sup>42</sup> as already stated in CHX rules as paragraph .03(2) of the Interpretations and Policies of Rule 19.<sup>43</sup> Although Exchange Act Rule 10C-1(b)(1)(iii)(A)(3) only exempts open-end management investment companies from the independence requirement of the Rule 10C-1(b), the Exchange proposes to expand that exemption, pursuant to Rule 10C-1(b)(5)(i) to include both open-end and closed-end management investment companies and to apply the exemption to all the requirements of Rule 10C-1. The Exchange submits that since registered investment companies are already subject to the requirements of the Investment Company Act, including, in particular, requirements concerning potential conflicts of interest related to investment adviser compensation,<sup>44</sup> requiring such companies to comport with the requirements of this proposed Rule 19(d) would be duplicative and unnecessary.

Proposed subparagraph (iii) exempts from the requirements of proposed Rule 19(d) passive business organizations, such as royalty trusts, or derivatives and

<sup>42</sup> *Supra* note 29.

<sup>43</sup> Paragraph .03(2) of the Interpretations and Policies of Rule 19 entitled, "Closed-End and Open-End Management Companies" states, "(A) Closed-end management companies that are registered under the Investment Company Act of 1940 are not required to comply with sections (a) through (f) of this Rule; except that closed-end funds must (i) maintain an audit committee of at least three persons; and (ii) comply with the provisions of SEC Rule 10A-3 and the provisions of paragraphs (b)(1)(A)(iv), (b)(1)(B), (b)(2), (b)(3) and (f), above, subject to applicable exceptions. Additionally, these issuers must establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company. (B) Business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act of 1940 that are not registered under that Act, are required to comply with all of the provisions of this Rule. (C) Open-end funds (including open-end funds that can be listed or traded as investment company units) are not required to comply with the provisions of sections (a) through (f) of this Rule; except that these funds must comply with the provisions of sections (b) and (f)(2), above, to the extent required by SEC Rule 10A-3. Additionally, these issuers must establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company and must address this responsibility in the audit committee charter."

<sup>44</sup> 15 USCS 80a-2, 15 USCS 80a-3, 15 USCS 80a-15, 15 USCS 80a-17, 15 USCS 80a-35 [sic].

special purpose entities, pursuant to the Exchange's discretion to exempt certain categories of issuers under Exchange Act Rule 10C-1(b)(5)(iii). Such issuers are already exempt from the current compensation committee requirements under paragraph .03(3) of the Interpretations and Policies of Rule 19.<sup>45</sup> The reasoning behind exempting passive business organizations, such as royalty trusts, is that such entities are structured fundamentally different from conventional equities issuers. For instance, in the case of royalty trusts, such entities do not have employees and virtually all profits earned are distributed to shareholders. As such, these entities have no need for compensation committees. Moreover, special purpose entities are frequently utilized to securitize receivables, such as loans. Similar to the reasoning behind exempting clearing agencies<sup>46</sup> that issue futures products and standardized options, purchasers of securities issued by such special purpose entities do not make an investment decision based on the issuer, but rather, the underlying security. As a result, information about the special purpose entities, its officers and directors and its financial statements is much less relevant to investors in these securities than information about the underlying security.

Proposed subparagraph (iv) exempts from the requirements of proposed Rule 19(d) any "foreign private issuer" that discloses in its annual report the reasons that it does not have an independent compensation committee, subject to the additional requirements of paragraph .03(4) of the Interpretations and Policies of Rule 19.<sup>47</sup> Moreover,

<sup>45</sup> Paragraph .03(3) of the Interpretations and Policies of Rule 19 states, "passive business organizations (such as royalty trusts) or derivatives and special purpose entities that are exempt from the requirements of SEC Rule 10A-3 are not subject to any requirement under sections (a) through (f) of this rule. To the extent that Rule 10A-3 applies to a passive business organization, derivative or special purpose security, such entities are required to comply with the provisions of paragraphs (b) and (f)(2) above, to the extent required by SEC Rule 10A-3."

<sup>46</sup> See Listing Standards for Compensation Committees, Release No. 33-9330 (June 27, 2012) [17 CFR Parts 229 and 240], at p. 51.

<sup>47</sup> Paragraph .03(4) of the Interpretations and Policies of Rule 19 states, "foreign issuers will be permitted to comply with their home country practices with respect to corporate governance (and thus are exempt from the requirements of sections (a)-(f), above), except to the extent that SEC Rule 10A-3 requires compliance with specific audit committee requirements in sections (b) and (f)(2) above. Foreign issuers must provide English language disclosure of any significant ways in which their corporate governance practices differ from those required for domestic issuers under this Rule 19. This disclosure may be provided either on

<sup>40</sup> Paragraph .03(1) of the Interpretations and Policies of Rule 19 states that "limited partnerships and companies in bankruptcy are not required to comply with sections (a), (c) and (d) above."

<sup>41</sup> See Unif. Ltd. P'ship Act sections 102, 303 and 404 (2001).

subparagraph (v) adopts the definition of “foreign private issuer” as stated under Exchange Act Rule 3b-4.<sup>48</sup> Pursuant to Exchange Act Rule 10C-1(b)(4)(ii), the Exchange proposes to expand the Exchange Act Rule 10C-1(b)(1)(iii)(A)(4) exemption of foreign private issuers from only the independence requirements to all requirements under Rule 10C-1. This is because foreign private issuers are already subject to corporate regulations of their respective home countries and requiring such issuers to comport with Exchange Act Rule 10C-1 would be cumulative, if not contradictory. In addition, the Exchange further proposes include a phase-in provision, nearly identical to proposed Section 303A.00 (Compliance Dates/A Company Ceases to Qualify as a Foreign Private Issuer) of the NYSE Listing Company Manual,<sup>49</sup> which requires compliance with the proposed compensation committee rules within six months of the date on which it failed to qualify as a foreign private issuer.

Proposed subparagraph (v) exempts from the requirements of proposed Rule 19(d) issuers listing only preferred or debt securities on the Exchange that are subject to the multiple listing exception described in paragraph .04 of the Interpretations and Policies of Rule 19, pursuant to the Exchange’s discretion to exempt certain categories of issuers under Exchange Act Rule 10C-1(b)(5)(iii). Such issuers are already exempt from the current compensation committee requirements under paragraph .03(5) of the Interpretations

and Policies of Rule 19.<sup>50</sup> The reasoning behind this exemption is that issuers of preferred or debt securities are already subject to the requirements of the rules of the exchange on which they are primarily listed. As such, this proposed exemption prevents such issuers from having to comport with multiple sets of rules. Moreover, holders of listed preferred stock have significantly greater protections with respect to their rights to receive dividends and a liquidation preference upon dissolution of the issuer. In addition, investors typically regard preferred stocks as a fixed income investment comparable to debt securities. Furthermore, debt securities are not equity securities, as they do not impart an ownership interest to the holder of such securities. Given these considerations, preferred and debt securities fall outside the scope of Exchange Act Rule 10C-1(a)(1) and should be generally exempt.

Proposed subparagraph (vi) exempts controlled companies from the requirements of proposed Rule 19(d), as mandated by Exchange Act Rule 10C-1(b)(5)(ii), with certain additional requirements.<sup>51</sup> Such issuers are already exempt from the current compensation committee requirements under current Rule 19(d)(3)(B).<sup>52</sup> Under Rule 19(p)(1), a “controlled company” is defined as a company in which an individual, group or another company, holds more than 50 percent of the voting power. This definition is consistent with Exchange Act Rule 10C-1(c)(3), which defines a “controlled company” as an issuer that is listed on a national securities exchange or by national securities association and of which more than 50 percent of the voting power for the election of directors is held by an individual, a group or another company. The Exchange further proposes to include this exemption under paragraph .03 of the Interpretations and Policies of Rule 19, as proposed paragraph .03(6).

<sup>50</sup> Paragraph .03(5) of the Interpretations and Policies of Rule 19 states, “issuers listing only preferred or debt securities on the Exchange typically will not be required to adhere to the requirements set out in sections (a)-(f) because they will be subject to the multiple listing exception described in Interpretation .04, below. To the extent required by SEC Rule 10A-3, these issuers will only be required to comply with sections (b) and (f)(2) above.”

<sup>51</sup> Pursuant to CHX paragraph .02 of the Interpretations and Policies of Rule 19, controlled companies that rely on this exemption are required to disclose in its annual proxy (or Form 10-K, 20-F, or other applicable annual disclosure filed with the SEC) that it is a controlled company and the basis for that determination.

<sup>52</sup> Current Rule 19(d)(3)(B) states, “controlled company is exempt from the requirements of this paragraph (d).”

Proposed subparagraph (vii) exempts from the requirements of proposed Rule 19(d) clearing agencies that are registered pursuant to Section 17A of the Exchange Act or that are exempt from the registration requirements of section 17A(b)(7)(A) of the Exchange Act that clear and list a security futures product or standardized option, pursuant to Exchange Act Rule 10C-1(b)(5)(iii) and (b)(5)(iv). The Exchange further proposes to include this exemption under paragraph .03 of the Interpretations and Policies of Rule 19, as proposed paragraph .03(7).

Moreover, proposed Rule 19(d)(5)(C) establishes a *limited exemption for smaller reporting companies* to proposed Rule 19(d) and proposed Rule 19(p)(5) merely states that the terms “small business issuer” and “smaller reporting company” means any issuer that meets the definition of “smaller reporting company” set out in SEC Rule 12b-2. Specifically, the limited exemption narrows the scope of the general exemption under Exchange Act Rule 10C-1(b)(5)(ii) and exempts smaller reporting companies only from the compensation adviser requirements of proposed Rule 19(d)(4) and the additional independent director requirements specific to compensation committees of proposed Rule 19(p)(3)(B). This is because under current CHX rules, small business issuers are already subject to independent director requirements for its compensation committees and, as such, the Exchange submits that requiring such issuers to continue to comply with similar proposed rules is not overly burdensome. Moreover, the proposed rule includes a phase-in provision similar to proposed Rule 19(d)(5)(B)(iv) for foreign private issuers and proposed Section 303A.00 (Compliance Dates/A Company Ceases to Qualify as a Smaller Reporting Company) of the NYSE Listing Company Manual,<sup>53</sup> which states that if the smaller reporting company ceases to qualify as such under SEC rules, it is required to (i) meet the additional

<sup>53</sup> Section 303A.00 (Compliance Dates/A Company Ceases to Qualify as a Smaller Reporting Company) states, in pertinent part, “under SEC Rule 12b-2, a company tests its status as a smaller reporting company on an annual basis at the end of its most recently completed second fiscal quarter [\* \* \*] To the extent a smaller reporting company ceases to qualify as such under SEC rules, it is required, if applicable, to: (1) Have a compensation committee of which all of the members meet the independence standards of Section 303A.02(a)(ii) within six months of the Smaller Reporting Company Determination Date; and (II) comply with Section 303A.05(c)(iv) as of the Smaller Reporting Company Determination Date.” The Commission notes that this is language proposed in NYSE-2012-049.

the issuer’s Web site or in the annual report distributed to shareholders in the U.S. If the disclosure is made only on an issuer’s Web site, the issuer must note that fact in its annual report and provide the Web address at which the disclosure may be reviewed.”

<sup>48</sup> Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)] defines “foreign private issuer” as “any foreign issuer other than a foreign government, except for an issuer that has more than 50% of its outstanding voting securities held of record by U.S. residents and any of the following: A majority of its officers and directors are citizens or residents of the United States, more than 50% of its assets are located in the United States, or its business is principally administered in the United States.”

<sup>49</sup> Section 303A.00 (Compliance Dates/A Company Ceases to Qualify as a Foreign Private Issuer) of the NYSE Listing Company Manual states, in pertinent part, “to the extent a foreign private issuer ceases to qualify as such under SEC rules (so that is required to file on domestic forms with the SEC), such company is required to comply with Section 303A domestic company requirements as follows: [\* \* \*] The company must have fully independent nominating and compensation committees as required by Sections 303A.04 and 303A.05, if applicable, within six months of the Foreign Private Issuer Determination Date.” The Commission notes that a portion of this language is proposed in NYSE-2012-049.

independent director requirements of proposed 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 the compensation adviser requirements of proposed Rule 19(d)(4) as of the date on which the issuer failed to qualify as a smaller reporting company.

#### Proposed Paragraph .05 of the Interpretations and Policies

Pursuant to the exemptive authority provided to the exchanges under Exchange Act Rule 10C-1(b)(1)(iii), the Exchange proposes to amend paragraph .05 (Transition Periods and Compliance Dates) of the Interpretations and Policies of Rule 19 to establish a transition period for issuers to conform to the requirements of proposed Rule 19, as proposed paragraph .05(6). Specifically, proposed paragraph .05(6) establishes that proposed Rule 19(d), Rule 19(p)(3), Rule 19(p)(5) and paragraphs .03 and .05 of the Interpretations and Policies of Rule 19 (which are all of the provisions that have been amended under this proposed rule filing) will become immediately operative upon approval by the SEC. However, issuers shall have until the earlier of its first annual shareholders meeting after January 15, 2014 or October 31, 2014 to comply with the compensation committee charter requirements of proposed Rule 19(d)(2), the compensation adviser requirements of proposed Rule 19(d)(4) and the additional independent director requirements of proposed Rule 19(p)(3)(B). That is, the amendments that do not require issuers to do anything in addition to what they are already required to do, under current rules, will become operative immediately upon approval and the amendments that place additional requirements on the issuers will be subject to the longer transition period.

This proposed transition period is similar to proposed Section 303A.00 (Transition Periods for Compensation Committee Requirements) of the NYSE Listed Company Manual, which provides that listed companies will have until the earlier of their first annual meeting after January 15, 2014 or October 31, 2004, to comply with the new standards with respect to compensation committees. The only difference between the NYSE proposed transition period and this proposed paragraph .05(6) is that the NYSE proposes to maintain current rule language operative through June 30, 2013, whereas the Exchange proposes to make amended rule language that does not substantively change the current compensation committee listing

standards immediately operative. However, the Exchange submits that both approaches are practically similar and the differences are based on how CHX rules are organized.

#### 2. Statutory Basis

The proposed rule change in relation to the Exchange's compensation committee requirements and the proposed compensation committee consultant independence requirements are consistent with the requirements of Rule 10C-1, with respect to the adoption by national securities exchange of compensation committee listing standards. Moreover, the proposed rule changes are consistent with Section 6(b) of the Act<sup>54</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>55</sup> in particular, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transaction in securities, to remove impediments and perfect the mechanisms of a free and open market, and, in general, to protect investors and the public interest. Specifically, the Exchange believes that the proposed rule change supports the objective of the Exchange Act by providing harmonization between CHX Rules and rules of all other organization subject to the requirements of Exchange Act Rule 10C-1, which would result in less burdensome and more efficient regulatory compliance. Moreover, the Exchange submits that the proposed amendments to its compensation committee listing standards are consistent with the protection of investors and the public interest in that they strengthen the independence requirements for compensation committee membership, provide additional authority to compensation committees and require compensation committees to consider the independence of compensation consultants.

Furthermore, the Exchange submits that the exemptions from the proposed requirements that it is granting to limited partnerships and companies in bankruptcies, management companies registered under the Investment Company Act of 1940, passive business organizations or derivatives and special purpose entities that are exempt from the requirements of Exchange Act 10A-3, foreign private issuers, issuer's listing only preferred or debt securities, controlled companies and clearing agencies that clear and list securities

futures products or standardized options are consistent with Section 10C and Rule 10C-1 for the reasons stated above in the "Purpose" section. Specifically, Rule 10C-1(b)(5)(ii) explicitly exempts smaller reporting companies and foreign private issuers will comply with their home country law and, if they avail themselves of the exemption, will be required to disclose that fact under existing Exchange listing requirements. Moreover, the Exchange submits it is an appropriate use of its exemptive authority under Rule 10C-1(b)(5)(i), and that it is not unfairly discriminatory under Section 6(b)(5) of the Act, to provide general exemptions under the proposed rules to issuers whose only listed class of equity securities on the Exchange is a preferred stock, as holders of listed preferred stock have significantly greater protections with respect to their rights to receive dividends and a liquidation preference upon dissolution of the issuer, and preferred stocks are typically regarded by investors as a fixed income investment comparable to debt securities, the issuers of which are exempt from compliance with Rule 10C-1. In addition, the Exchange submits that it is an appropriate use of its exemptive authority under Rule 10C-1(b)(5)(i) and that is not unfairly discriminatory under Section 6(b)(5) of the Exchange Act, to provide general exemptions under the proposed rules for all of the other categories of issuers that are not currently subject to the Exchange's compensation committee requirement, for the structural reasons discussed in the "Purpose" section and because it would be a significant and unnecessarily burdensome alteration in their governance structures to require them to comply with the proposed new requirements.

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i)

<sup>54</sup> 15 U.S.C. 78f(b).

<sup>55</sup> 15 U.S.C. 78f(b)(5).

as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is 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-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 offices 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-CHX-2012-13, and should be submitted on or before November 6, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>56</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

[FR Doc. 2012-25407 Filed 10-15-12; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68030; File No. SR-NYSEArca-2012-88]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Approval of Proposed Rule Change to List and Trade Shares of the RiverFront Strategic Income Fund under NYSE Arca Equities Rule 8.600

October 10, 2012.

#### I. Introduction

On August 10, 2012, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") 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 list and trade shares ("Shares") of the RiverFront Strategic Income Fund ("Fund") under NYSE Arca Equities Rule 8.600. The proposed rule change was published for comment in the **Federal Register** on August 28, 2012.<sup>3</sup> The Commission received no comments on the proposal. This order grants approval of the proposed rule change.

#### II. Description of the Proposed Rule Change

The Exchange proposes to list and trade the Shares of the Fund pursuant to NYSE Arca Equities Rule 8.600, which governs the listing and trading of Managed Fund Shares on the Exchange. The Shares will be offered by ALPS ETF Trust ("Trust"), a statutory trust organized under the laws of the State of Delaware and registered with the Commission as an open-end management investment company.<sup>4</sup> The

Fund will be managed by WisdomTree Asset Management, Inc. ("WisdomTree" or the "Adviser"). RiverFront Investment Group, LLC ("RiverFront") is the investment sub-adviser for the Fund (the "Sub-Adviser"). The Exchange represents that, while the Adviser is not affiliated with a broker-dealer, the Sub-Adviser is affiliated with a broker-dealer and has implemented a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition and/or changes to the portfolio.<sup>5</sup>

#### *RiverFront Strategic Income Fund*

The investment objective of the Fund is to seek total return with an emphasis on income as the source of that total return by investing in a global portfolio of fixed income securities of various maturities, ratings and currency denominations. The Fund intends to utilize various investment strategies in a broad array of fixed income sectors. The Fund will allocate its investments based upon the analysis of the Sub-Adviser of the pertinent economic and market conditions, as well as yield, maturity and currency considerations.

The Fund may purchase fixed income securities issued by U.S. or foreign corporations<sup>6</sup> or financial institutions, including debt securities of all types and maturities, convertible securities and preferred stocks. The Fund also may purchase securities issued or guaranteed by the U.S. Government or foreign governments (including foreign states, provinces and municipalities) or their agencies and instrumentalities or issued or guaranteed by international organizations designated or supported

<sup>23</sup>, 2012, the Trust filed with the Commission an amendment to its registration statement on Form N-1A under the Securities Act of 1933 ("Securities Act") and under the 1940 Act relating to the Fund (File Nos. 333-148826 and 811-22175) ("Registration Statement"). In addition, the Commission has issued an order granting certain exemptive relief to the Trust under the 1940 Act. See Investment Company Act Release No. 28471 (October 27, 2008) (File No. 812-13458).

<sup>5</sup> See Commentary .06 to NYSE Arca Equities Rule 8.600. The Exchange represents that in the event (a) the Adviser or Sub-Adviser becomes newly affiliated with a broker-dealer, or (b) any new adviser or sub-adviser becomes affiliated with a broker-dealer, it will implement a fire wall with respect to such broker-dealer regarding access to information concerning the composition and/or changes to the portfolio and will be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding such portfolio.

<sup>6</sup> The Fund will invest only in securities that the Adviser or Sub-Adviser deems to be sufficiently liquid. While foreign corporate debt generally must have \$200 million or more par amount outstanding and significant par value traded to be considered as an eligible investment, at least 80% of issues of foreign corporate debt held by the Fund will have \$200 million or more par amount outstanding.

<sup>56</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. 67715 (August 22, 2012), 77 FR 52083 ("Notice").

<sup>4</sup> The Trust is registered under the Investment Company Act of 1940 ("1940 Act"). On February