



8011-01p
SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229 and 240

[Release Nos. 33-9330; 34-67220; File No. S7-13-11]

RIN 3235-AK95

Listing Standards For Compensation Committees

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting a new rule and amendments to our proxy disclosure rules to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10C to the Securities Exchange Act of 1934. Section 10C requires the Commission to adopt rules directing the national securities exchanges and national securities 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. In accordance with the statute, new Rule 10C-1 directs the national securities exchanges to establish listing standards that, among other things, require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent," as defined in the listing standards of the national securities exchanges adopted in accordance with the final rule. In addition, pursuant to Section 10C(c)(2), we are adopting amendments to our proxy disclosure rules concerning issuers' use of compensation consultants and related conflicts of interest.

DATES: Effective Date: [insert date 30 days after publication in the Federal Register].

Compliance Dates: Each national securities exchange and national securities association must provide to the Commission, no later than [insert date 90 days after publication in the Federal Register], proposed rule change submissions that comply with the requirements of Exchange Act

Rule 10C-1. Further, each national securities exchange and national securities association must have final rules or rule amendments that comply with Rule 10C-1 approved by the Commission no later than June 27, 2012. Issuers must comply with the disclosure changes in Item 407 of Regulation S-K in any proxy or information statement for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors will be elected occurring on or after January 1, 2013.

FOR FURTHER INFORMATION CONTACT: N. Sean Harrison, Special Counsel, Office of Rulemaking, at (202) 551-3430, or Heather Maples, Senior Special Counsel, Office of Chief Counsel, at (202) 551-3520, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are adopting new Rule 10C-1 under the Securities Exchange Act of 1934¹ and amendments to Item 407² of Regulation S-K.³

TABLE OF CONTENTS

- I. BACKGROUND AND SUMMARY
- II. DISCUSSION OF THE FINAL RULES
 - A. Exchange Listing Standards
 - 1. Applicability of Listing Standards
 - a. Proposed Rule
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - 2. Independence Requirements
 - a. Proposed Rule
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - 3. Authority to Retain Compensation Advisers; Responsibilities; and Funding

¹ 15 U.S.C. 78a *et seq.*

² 17 CFR 229.407.

³ 17 CFR 229.10 through 229.1208.

- a. Proposed Rule
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - 4. Compensation Adviser Independence Factors
 - a. Proposed Rule
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - 5. Opportunity to Cure Defects
 - a. Proposed Rule
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - B. Implementation of Listing Requirements
 - 1. Exchanges and Securities Affected
 - a. Proposed Rule
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - 2. Exemptions
 - a. Proposed Rule
 - i. Issuers Not Subject to Compensation Committee Independence Requirements
 - ii. Exemption of Relationships and Other Categories of Issuers
 - b. Comments on the Proposed Rule
 - c. Final Rule
 - C. Compensation Consultant Disclosure and Conflicts of Interest
 - 1. Proposed Rule
 - 2. Comments on the Proposed Rule
 - 3. Final Rule
 - a. Disclosure Requirements
 - b. Disclosure Exemptions
 - c. Disclosure Regarding Director Compensation
 - D. Transition and Timing
- III. PAPERWORK REDUCTION ACT
 - A. Background
 - B. Summary of the Final Rules
 - C. Summary of Comment Letters and Revisions to Proposals
 - D. Revisions to PRA Reporting and Cost Burden Estimates
- IV. ECONOMIC ANALYSIS
 - A. Background and Summary of the Rule Amendments
 - B. Benefits and Costs, and Impact on Efficiency, Competition and Capital Formation
 - 1. Section 10C of the Exchange Act, as added by Section 952 of the Act
 - 2. Discretionary Amendments
- V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

- A. Need for the Amendments
- B. Significant Issues Raised by Public Comments
- C. Small Entities Subject to the Final Rules
- D. Reporting, Recordkeeping and Other Compliance Requirements
- E. Agency Action to Minimize Effect on Small Entities

VI. STATUTORY AUTHORITY AND TEXT OF THE AMENDMENTS

I. BACKGROUND AND SUMMARY

On March 30, 2011, we proposed a new rule and rule amendments⁴ to implement Section 10C of the Securities Exchange Act of 1934 (the “Exchange Act”),⁵ as added by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”).⁶ Section 10C requires the Commission to direct the national securities exchanges⁷ (the “exchanges”) and national securities associations⁸ to prohibit the listing of any equity security of an issuer, with certain exceptions, that does not comply with Section 10C’s compensation committee and compensation adviser requirements.⁹

⁴ See Release No. 33-9199 (Mar. 30, 2011) [76 FR 18966] (the “Proposing Release”).

⁵ 15 U.S.C. 78j-3.

⁶ Pub. L. No. 111-203, 124 Stat. 1900 (2010).

⁷ A “national securities exchange” is an exchange registered as such under Section 6 of the Exchange Act [15 U.S.C. 78f]. There are currently sixteen national securities exchanges registered under Section 6(a) of the Exchange Act: NYSE Amex (formerly the American Stock Exchange), BATS Exchange, BATS Y-Exchange, BOX Options Exchange, C2 Options Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, EDGA Exchange, EDGX Exchange, International Securities Exchange, NASDAQ OMX BX (formerly the Boston Stock Exchange), The NASDAQ Stock Market, National Stock Exchange, New York Stock Exchange, NYSE Arca and NASDAQ OMX PHLX (formerly Philadelphia Stock Exchange). Certain exchanges are registered with the Commission through a notice filing under Section 6(g) of the Exchange Act for the purpose of trading security futures. See Section II.B.1, below, for a discussion of these types of exchanges.

⁸ A “national securities association” is an association of brokers and dealers registered as such under Section 15A of the Exchange Act [15 U.S.C. 78o-3]. The Financial Industry Regulatory Authority (“FINRA”) is the only national securities association registered with the Commission under Section 15A of the Exchange Act. FINRA does not list equity securities; therefore, we refer only to national securities exchanges in this release.

In addition, Section 15A(k) of the Exchange Act [15 U.S.C. 78o-3(k)] provides that a futures association registered under Section 17 of the Commodity Exchange Act [7 U.S.C. 21] shall be registered as a national securities association for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products pursuant to Section 15(b)(11) of the Exchange Act [15 U.S.C. 78o(b)(11)]. See Section II.B.1, below, for a discussion regarding security futures products.

⁹ See Exchange Act Sections 10C(a) and (f).

Specifically, Section 10C(a)(1) of the Exchange Act requires 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.”¹⁰ The term “independent” is not defined in Section 10C. Instead, Section 10C(a)(3) provides that “independence” is to be defined by the exchanges after taking into consideration “relevant factors,” which are required to include (1) a director’s source of compensation, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and (2) whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. Section 10C(a)(4) of the Exchange Act requires our rules 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.

In addition to the independence requirements set forth in Section 10C(a), Section 10C(f) of the Exchange Act requires the Commission to adopt rules directing the exchanges to establish listing standards that provide for the following 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:

- Each compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of compensation advisers;¹¹

¹⁰ Five categories of issuers are excluded from this requirement: controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act of 1940 (the “Investment Company Act”), and foreign private issuers that disclose in their annual reports the reasons why they do not have an independent compensation committee.

¹¹ Exchange Act Sections 10C(c)(1)(A) and 10C(d)(1).

- Before selecting any compensation adviser, the compensation committee must take into consideration specific factors identified by the Commission that affect the independence of compensation advisers;¹²
- The compensation committee must be directly responsible for the appointment, compensation and oversight of the work of compensation advisers;¹³ and
- Each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.¹⁴

Finally, Section 10C(c)(2) requires 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.

We proposed new Exchange Act Rule 10C-1 to implement the compensation committee listing requirements of Sections 10C(a)-(g)¹⁵ of the Exchange Act. We proposed rule amendments to Item 407 of Regulation S-K to require the disclosures mandated by Section 10C(c)(2), which are to be provided in any proxy or information statement relating to an annual meeting of shareholders at which directors are to be elected (or special meeting in lieu of the

¹² Exchange Act Section 10C(b).

¹³ Exchange Act Sections 10C(c)(1)(B) and 10C(d)(2).

¹⁴ Exchange Act Section 10C(e).

¹⁵ Section 10C(g) of the Exchange Act exempts controlled companies from the requirements of Section 10C.

annual meeting). In connection with these amendments, we also proposed to revise the current disclosure requirements with respect to the retention of compensation consultants.

The comment period for the Proposing Release closed on May 19, 2011.¹⁶ We received 58 comment letters from 56 different commentators, including pension funds, corporations, compensation consulting firms, professional associations, trade unions, institutional investors, investment advisory firms, law firms, academics, individual investors and other interested parties. Commentators generally supported the proposed implementation of the new requirements. Some commentators urged us to adopt additional requirements not mandated by the Act. Other commentators opposed some aspects of the proposed rule and rule amendments and suggested modifications to the proposals.

We have reviewed and considered all of the comments that we received on the proposals. The final rules reflect a number of changes made in response to these comments. We discuss our revisions with respect to the proposed rule and rule amendments in more detail throughout this release.

II. DISCUSSION OF THE FINAL RULES

A. Exchange Listing Standards

1. Applicability of Listing Standards

We proposed to direct the exchanges to adopt listing standards that would apply Section 10C's independence requirements to members of a listed issuer's compensation committee as well as any committee of the board that performs functions typically performed by a compensation committee. We are adopting this aspect of the rule substantially as proposed, but with one change reflecting comments we received.

¹⁶ We extended the original comment period deadline from April 29, 2011 to May 19, 2011. See Listing Standards for Compensation Committees, Release No. 33-9203 (Apr. 29, 2011)[76 FR 25273].

a. Proposed Rule

In enacting Section 10C of the Exchange Act, Congress intended to require that “board committees that set compensation policy will consist only of directors who are independent.”¹⁷ In addition, Congress sought to provide “shareholders in a public company” with “additional disclosures involving compensation practices.”¹⁸ Although Section 10C includes numerous provisions applicable to the “compensation committees” of listed issuers, it does not require a listed issuer to have a compensation committee or a committee that performs functions typically assigned to a compensation committee. Moreover, Section 10C does not provide that, in the absence of a compensation committee, the entire board of directors will be considered to be the compensation committee, nor does it include provisions that have the effect of requiring a compensation committee as a practical matter.

Neither the Act nor the Exchange Act defines the term “compensation committee.”¹⁹ Our rules do not currently require that a listed issuer establish a compensation committee. Current exchange listing standards, however, generally require listed issuers either to have a compensation committee or to have independent directors determine, recommend or oversee specified executive compensation matters.²⁰ For example, the New York Stock Exchange

¹⁷ 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).

¹⁸ Id.

¹⁹ By contrast, Section 3(a)(58) of the Exchange Act defines an “audit committee” as “a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and . . . if no such committee exists with respect to an issuer, the entire board of directors of the issuer.”

²⁰ There are some exchanges registered under Section 6(a) of the Exchange Act that have not adopted listing standards that require executive compensation determinations for listed issuers to be made or recommended by an independent compensation committee or independent directors. However, these exchanges, which include the BOX Options Exchange, International Securities Exchange, EDGA Exchange, EDGX Exchange, BATS Y-Exchange, and C2 Options Exchange, currently either trade securities only pursuant to unlisted trading privileges or trade only standardized options. In addition, the listing standards of certain exchanges that are registered with the Commission for the purpose of trading security futures do not address executive compensation matters. See Section II.B.1, below, for a discussion of these types of exchanges.

(“NYSE”) requires a listed issuer to have a compensation committee composed solely of independent directors and to assign various executive compensation-related tasks to that committee.²¹ On the other hand, the NASDAQ Stock Market (“Nasdaq”) does not mandate that a listed issuer have a compensation committee, but requires that executive compensation be determined or recommended to the board for determination either by a compensation committee composed solely of independent directors or by a majority of the board’s independent directors in a vote in which only independent directors participate.²² Some of the other exchanges have standards comparable to the NYSE’s and require their listed issuers to have independent compensation committees.²³ Other exchanges have standards comparable to Nasdaq’s and, in the absence of a compensation committee, require executive compensation determinations to be made or recommended by a majority of independent directors on the listed issuer’s board.²⁴

Proposed Rule 10C-1(b) would direct the exchanges to adopt listing standards that would apply to a listed issuer’s compensation committee or, in the absence of such a committee, any other board committee that performs functions typically performed by a compensation committee, including oversight of executive compensation. Proposed Rule 10C-1(b), however,

²¹ See NYSE Listed Company Manual Section 303A.05. Section 303A.05 permits a listed issuer’s board to allocate the responsibilities of the compensation committee to another committee, provided that the committee is composed entirely of independent directors and has a committee charter. The NYSE exempts certain issuers from this requirement, including controlled companies, limited partnerships, companies in bankruptcy, and closed-end and open-end management investment companies registered under the Investment Company Act. See NYSE Listed Company Manual Section 303A.00.

²² See Nasdaq Rule 5605(d). Based on data supplied by Nasdaq, we understand that fewer than 2% of its listed issuers utilize the alternative of having independent board members, and not a committee, oversee compensation. See also Nasdaq IM 5605-6 (stating that the Nasdaq rule “is intended to provide flexibility for a [c]ompany to choose an appropriate board structure and to reduce resource burdens, while ensuring [i]ndependent [d]irector control of compensation decisions.”). Nasdaq exempts certain issuers from this requirement, including asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies registered under the Investment Company Act, and controlled companies. See Nasdaq Rules 5615(a) and 5615(c)(2).

²³ See NYSE Arca Rule 5.3(k)(4); National Stock Exchange Rule 15.5(d)(5); and NASDAQ OMX PHLX Rule 867.05.

²⁴ See NASDAQ OMX BX Rule 4350(c)(3); NYSE Amex Company Guide Section 805; Chicago Board Options Exchange Rule 31.10; Chicago Stock Exchange Article 22, Rules 19(d) and 21; and BATS Exchange Rule 14.10(c)(4).

would not require the independence listing requirements to apply to members of the board who oversee executive compensation in the absence of a board committee.²⁵

b. Comments on the Proposed Rule

Comments on this proposal were generally favorable. Many commentators supported the functional approach of the proposed rule, which would require compensation committee independence listing standards to apply to any board committee charged with oversight of executive compensation, regardless of its formal title.²⁶ In response to our request for comment on whether we should direct the exchanges to apply the proposed rule’s requirements to directors who oversee executive compensation matters in the absence of a formal committee structure, several commentators recommended that we do so,²⁷ and two of these commentators suggested that such a requirement would help ensure that companies could not rely on technicalities or loopholes to avoid independent director oversight of executive compensation.²⁸ Another commentator, however, argued that the final rule should not apply to independent directors who determine, or recommend to the board, executive compensation matters in the absence of a formal committee structure.²⁹ This commentator believed that broadening the scope of the rule to apply to a group of directors who determine executive compensation in lieu of a formal committee is not clearly mandated by Section 10C and would burden listed issuers that do not

²⁵ As noted, to the extent no board committee is authorized to oversee executive compensation, under applicable listing standards, board determinations with respect to executive compensation matters may be made by the full board with only independent directors participating. In such situations, under state corporate law, we understand that action by the independent directors would generally be considered action by the full board, not action by a committee.

²⁶ See, e.g., letters from Chris Barnard (“Barnard”), the Chartered Financial Analyst Institute (“CFA”) and Railpen Investments (“Railpen”).

²⁷ See, e.g., letters from Barnard, Better Markets Inc. (“Better Markets”), CFA, Georg Merkl (“Merkl”), National Association of Corporate Directors (“NACD”) and Railpen.

²⁸ See letters from NACD and Railpen.

²⁹ See letter from the American Bar Association, Business Law Section (“ABA”).

have a board committee overseeing executive compensation, without necessarily improving their oversight of executive compensation.³⁰

In the Proposing Release, we requested comment on whether the exchanges should be prohibited from listing issuers that do not have compensation committees. Several commentators supported the concept of mandatory compensation committees for listed issuers, on the basis that executive compensation deserves special, ongoing attention by a dedicated working group of the board; a committee structure may promote increased board expertise on compensation; and having a formal committee would help promote accountability to shareholders.³¹ Several other commentators opposed such requirements, arguing that the exchanges should be allowed broad discretion on how listed issuers determine compensation matters.³²

c. Final Rule

After considering the comments, we are adopting Rule 10C-1(b) substantially as proposed. Under the final rule, the exchanges will be directed to adopt listing standards that apply to any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not such committee also performs other functions or is formally designated as a compensation committee.³³ In addition, the listing standards adopted by the exchanges must also apply the

³⁰ This commentator also noted that, “[a]s a practical matter, we understand that most listed companies that are accelerated filers under the Exchange Act, and many listed companies that are smaller reporting companies, already have compensation committees or committees performing the functions of compensation committees.” *Id.*

³¹ *See* letters from the American Federation of Labor and Congress of Industrial Organizations (“AFL-CIO”), the Council of Institutional Investors (“CII”), Merkl and the Ohio Public Employees’ Retirement System (“OPERS”).

³² *See* letters from ABA, CFA and NACD.

³³ For example, if a listed issuer has a “corporate governance committee” or a “human resources committee,” the responsibilities of which include, among other matters, oversight of executive compensation, such committee will be subject to the compensation committee listing requirements of the applicable exchange.

director independence requirements of Rule 10C-1(b)(1), the requirements relating to consideration of a compensation adviser's independence in Rule 10C-1(b)(4), and the requirements relating to responsibility for the appointment, compensation and oversight of compensation advisers in Rules 10C-1(b)(2)(ii) and (iii) to the members of a listed issuer's board of directors who, in the absence of a board committee, oversee executive compensation matters on behalf of the board of directors. We believe this approach is an appropriate way to implement Section 10C. The listing standards are intended to benefit investors by requiring that the independent directors of a listed issuer oversee executive compensation matters, consider independence criteria before retaining compensation advisers and have responsibility for the appointment, compensation and oversight of these advisers. We believe it would benefit investors to implement Section 10C in a manner that does not allow listed issuers to avoid these listing standards by simply not having a compensation committee or another board committee oversee executive compensation matters.

We have determined not to require the exchanges to apply the listing standards relating to the compensation committee's authority to retain compensation advisers, Rule 10C-1(b)(2)(i), or required funding for payment of such advisers to directors who oversee executive compensation matters outside of the structure of a formal board committee, Rule 10C-1(b)(3). As noted above, we understand that action by independent directors acting outside of a formal committee structure would generally be considered action by the full board of directors. As a result, we believe it is unnecessary to apply these requirements 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.

We are implementing this change by defining the term “compensation committee” so that it includes, for all purposes other than the requirements relating to the authority to retain compensation advisers in Rule 10C-1(b)(2)(i) and required funding for payment of such advisers in Rule 10C-1(b)(3), the members of the board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a formal committee. For ease of reference throughout this release, in our discussion of the final rules we are adopting, references to an issuer’s “compensation committee” include any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not formally designated as a “compensation committee,” as well as, to the extent applicable, those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of such a committee.

The final rule will not require a listed issuer to have a compensation committee or a committee that performs functions typically assigned to a compensation committee. We believe this aspect of the final rule is consistent with the requirements of Section 10C, which does not direct us to require such a committee. Moreover, in light of our determination to apply the requirements for director independence, consideration of adviser independence, and responsibility for the appointment, compensation and oversight of compensation advisers to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a formal committee, there will be little difference between the requirements applicable to listed issuers that do not have compensation committees as compared to those applicable to issuers that do have compensation committees.

2. Independence Requirements

Proposed Rule 10C-1(b)(1) would require each member of a listed issuer's compensation committee to be a member of the board of directors and to be independent. We proposed to require that the exchanges develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, the two factors enumerated in Section 10C(a)(3). We are adopting these requirements as proposed, except that, as discussed above, this aspect of the final rule will also apply to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee.

a. Proposed Rule

Most exchanges that list equity securities already require directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under their general independence standards. Although independence requirements and standards vary somewhat among the different exchanges, listing standards generally prescribe certain bright-line independence tests (including restrictions on compensation, employment and familial or other relationships with the listed issuer or the executive officers of the listed issuer that could interfere with the exercise of independent judgment) that directors must meet in order to be considered independent.³⁴ For example, both NYSE and Nasdaq rules preclude a finding of independence if the director is or recently was employed by the listed issuer, the director's immediate family member is or recently was employed as an executive officer of the listed issuer, or the director or director's family member

³⁴ See NYSE Listed Company Manual Section 303A.02(b); Nasdaq Rule 5605(a)(2).

received compensation from the listed issuer in excess of specified limits.³⁵ In addition, under both NYSE and Nasdaq rules, directors may be disqualified based on their or their family members' relationships with a listed issuer's auditor, affiliation with entities that have material business relationships with the listed issuer, or employment at a company whose compensation committee includes any of the listed issuer's executive officers.³⁶ We note, however, that with the exception of audit committee membership requirements, stock ownership alone will not automatically preclude a director from being considered independent under either NYSE or Nasdaq listing standards.³⁷ The NYSE and Nasdaq also require their listed issuers' boards to affirmatively determine that each independent director either, in NYSE's case, has no material relationship with the issuer³⁸ or, in Nasdaq's case, has no relationship which, in the opinion of the issuer's board of directors, would interfere with the director's exercise of independent judgment in carrying out his or her responsibilities.³⁹ The other exchanges have similar requirements.⁴⁰

In addition to meeting exchange listing standards, there are other reasons for members of the compensation committee to be independent. For example, in order for a securities transaction between an issuer and one of its officers or directors to be exempt from short-swing profit liability under Section 16(b) of the Exchange Act, the transaction must be approved by the full board of directors or by a committee of the board that is composed solely of two or more

³⁵ See id.

³⁶ See id.

³⁷ See Commentary to NYSE Listed Company Manual Section 303A.02(a); Nasdaq Rule 5605; Nasdaq IM-5605.

³⁸ See NYSE Rule 303A.02(a).

³⁹ See Nasdaq Rule 4200(a)(15).

⁴⁰ See, e.g., NYSE Arca Rule 5.3(k)(1) and NYSE AMEX Company Guide Section 803.A.02.

“Non-Employee Directors,” as defined in Exchange Act Rule 16b-3(b)(3).⁴¹ We understand that many issuers use their independent compensation committees to avail themselves of this exemption.⁴² Similarly, if an issuer wishes to preserve the tax deductibility of the amounts of certain awards paid to executive officers, among other things, the performance goals of such awards must be determined by a compensation committee composed of two or more “outside directors,” as defined in Section 162(m) of the Internal Revenue Code.⁴³ The definitions of “Non-Employee Director” and “outside director” are similar to the exchanges’ definitions of independent director.

The proposed rule would direct the exchanges to develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, a director’s source of compensation, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and whether a director is affiliated with the

⁴¹ As defined in Exchange Act Rule 16b-3(b)(3)(i) [17 CFR 240.16b-3(b)(3)(i)], a “Non-Employee Director” is a director who is not currently an officer (as defined in Rule 16a-1(f)) 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; does not receive 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 the dollar amount for which disclosure would be required pursuant to Item 404(a) of Regulation S-K; and does not possess an interest in any other transaction for which disclosure would be required pursuant to Item 404(a) of Regulation S-K. In addition, Rule 16b-3(b)(3)(ii) provides that a Non-Employee Director of a closed-end investment company is a director who is not an “interested person” of the issuer, as that term is defined in Section 2(a)(19) of the Investment Company Act [15 U.S.C. 80a-2(a)(19)].

⁴² See letter from Sullivan & Cromwell LLP to Facilitating Shareholder Director Nominations, Release No. 34-60089, available at <http://www.sec.gov/comments/s7-10-09/s71009-430.pdf> (“In our experience, many compensation committee charters require their members to meet the requirements of Rule 16b-3 and Section 162(m).”); Ira G. Bogner & Michael Krasnovsky, “Exchange Rules Impact Compensation Committee Composition,” *The Metropolitan Corporate Counsel*, Apr. 2004, at 17 (“Most compensation committees of public companies include at least two directors that are ‘outside directors’ under Section 162(m) of the Internal Revenue Code... and ‘non-employee directors’ under Rule 16b-3 of the Securities Exchange Act...”).

⁴³ A director is an “outside director” if the director (A) is not a current employee of the publicly held corporation; (B) is not a former employee of the publicly held corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year; (C) has not been an officer of the publicly held corporation; and (D) does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services. Section 162(m) of the Internal Revenue Code of 1986, as amended. Treas. Reg. Section 1.162-27(e)(3).

issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. We did not propose to specify any additional factors that the exchanges must consider in determining independence requirements for members of compensation committees.

In proposing Rule 10C-1(b)(1), we considered the similarities and differences between Section 952 of the Act and Section 301 of the Sarbanes-Oxley Act of 2002.⁴⁴ Section 301 of the Sarbanes-Oxley Act added Section 10A(m)(1) to the Exchange Act,⁴⁵ which required the Commission to direct the exchanges to prescribe independence requirements for audit committee members. Although the independence factors in Section 10C(a)(1) are similar to those in Section 10A(m)(1) – and indeed, Section 952 of the Act essentially provides the compensation committee counterpart to the audit committee requirements of Section 301 of the Sarbanes-Oxley Act – one significant difference is that Section 10C(a) requires only that the exchanges “consider relevant factors” (emphasis added), which include the source of compensation and any affiliate relationship, in developing independence standards for compensation committee members, whereas Section 10A(m) expressly states that certain relationships preclude independence: an audit committee member “may not, other than in his or her capacity as a member of the audit committee...[a]ccept any consulting, advisory, or other compensatory fee from the issuer; or [b]e an affiliated person of the issuer or any subsidiary thereof” (emphasis added).⁴⁶

As a result, we interpret Section 10C as providing the exchanges more discretion to determine the standards of independence that compensation committee members are required to

⁴⁴ Pub. L. 107-204, 116 Stat. 745 (2002).

⁴⁵ 15 U.S.C. 78j-1(m)(1).

⁴⁶ See Section 10A(m) of the Exchange Act. Exchange Act Rule 10A-3 states that in order to be considered “independent,” an audit committee member “may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee . . . [a]ccept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof” For non-investment company issuers, the audit committee member also cannot be an affiliated person of the issuer or its subsidiaries. For investment company issuers, the audit committee member cannot be an “interested person” of the issuer as defined in Section 2(a)(19) of the Investment Company Act.

meet than they are provided under Section 10A with respect to audit committee members. Section 10A(m) prescribes minimum criteria for the independence of audit committee members. In contrast, Section 10C gives the exchanges the flexibility to establish their own minimum independence criteria for compensation committee members after considering relevant factors, including the two enumerated in Section 10C(a)(3). Accordingly, the proposed rule would allow each exchange to establish its own independence definition, subject to Commission review and approval pursuant to Section 19(b) of the Exchange Act, provided the exchange considers relevant factors in establishing its own standards, including those specified in Section 10C(a)(3).

b. Comments on the Proposed Rule

Comments on this proposal were generally favorable. Many commentators supported permitting the exchanges to establish their own independence criteria for compensation committee members, provided they consider the statutorily-required factors.⁴⁷ One commentator claimed that this approach would utilize the relative strengths and experiences of the exchanges by avoiding a “one size fits all” approach and could be more conducive to responding quickly to changes in corporate governance.⁴⁸ Another commentator noted that the proposal permitted each exchange to develop more finely tuned listing rules that reflect the particular characteristics of each exchange’s listed companies.⁴⁹

⁴⁷ See, e.g., letters from ABA, Barnard, Sanjai Bhagat, et al. (“Bhagat”), the Center on Executive Compensation (“CEC”), CFA, Davis Polk & Wardwell LLP (“Davis Polk”), MarkWest Energy Partners, L.P. (“MarkWest”), NYSE Euronext (“NYSE”), Pfizer Inc. (“Pfizer”) and Sullivan & Cromwell LLP (“S&C”).

⁴⁸ See letter from MarkWest.

⁴⁹ See letter from ABA (noting that “the average board size of an S&P 100 company (which are primarily listed on the NYSE) is approximately 50% larger than the average board size of a Silicon Valley 150 company (which are primarily listed on Nasdaq” and that “[i]nvestors in these disparate categories of companies have meaningfully different expectations and interests in the governance context”).

Allowing the exchanges the latitude to establish their own independence criteria concerned some commentators, however.⁵⁰ These commentators cautioned against permitting the exchanges to establish their own independence criteria and argued in support of a uniform definition of independence across all exchanges.⁵¹ One of these commentators claimed that uniform requirements would serve as a deterrent to engaging in a “race to the bottom.”⁵² Another commentator recommended that the exchanges’ independence criteria should preclude a finding of independence if a director fails to meet the definitions of an “outside” director under Section 162(m) of the Internal Revenue Code or a “non-employee” director under Exchange Act Rule 16b-3(b)(3); is a party to a related party transaction that must be disclosed pursuant to Item 404 of Regulation S-K; or has an immediate family member who is employed by the company.⁵³

Some commentators urged us to require the exchanges to consider additional factors in developing a definition of independence.⁵⁴ Several commentators advocated that we should require the exchanges to include business or personal relationships between a compensation committee member and executive officers of the issuer as factors for consideration,⁵⁵ as well as board interlocks.⁵⁶ Another commentator believed that mandatory factors for consideration should include linkages between a director’s family members and the company or its affiliates

⁵⁰ See, e.g., letters from the American Federation of State, County and Municipal Employees (“AFSCME”), California Public Employees’ Retirement System (“CalPERS”), the Colorado Public Employees’ Retirement Association (“COPERA”), OPERS and USS.

⁵¹ See letters from CalPERS, Railpen and USS.

⁵² See letter from USS.

⁵³ See letter from AFL-CIO.

⁵⁴ See, e.g., letters from AFSCME, Better Markets, CFA, CII, the State Board of Administration of Florida (“FLSBA”) and UAW Retiree Medical Benefits Trust (“UAW”).

⁵⁵ See, e.g., letters from AFL-CIO, AFSCME, CFA, CII, FLSBA and UAW.

⁵⁶ See, e.g., letters from AFSCME, CII, FLSBA and UAW.

and a director's relationships with other directors.⁵⁷ One commentator believed that, in setting independence standards for compensation committee members, the exchanges should be required to consider all factors relevant to assessing the independence of a board member, including personal, family and business relationships, and all other factors that might compromise a board member's judgment on matters relating to executive compensation.⁵⁸

Three commentators, including the NYSE, stated that we should not specify additional mandatory factors that the exchanges must consider in developing a definition of independence applicable to compensation committee members.⁵⁹ In particular, the NYSE expressed concern that if the final rule specifies additional mandatory factors for consideration, such factors would be understood by the exchanges and by many boards of directors as the Commission's determination that such relationships compromise director independence, which would thereby effectively preempt the review of compensation committee independence standards that the exchanges would be required to undertake under the rule.⁶⁰

In the Proposing Release, we noted the concern of several commentators⁶¹ that our rules implementing Section 10C not prohibit directors affiliated with significant investors (such as private equity funds and venture capital firms) from serving on compensation committees. We requested comment on whether a director affiliated with a shareholder with a significant

⁵⁷ See letter from CII.

⁵⁸ See letter from Better Markets.

⁵⁹ See letters from ABA, NYSE and the Society of Corporate Secretaries and Governance Professionals ("SCSGP").

⁶⁰ See letter from NYSE.

⁶¹ To facilitate public input on the Act, the Commission has provided a series of e-mail links, organized by topic, on its website at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we received on Section 952 of the Act before we issued the Proposing Release are available on our website at <http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml>. Several of those commentators suggested that stock ownership alone should not automatically disqualify a board member from serving as an independent director on the compensation committee. See, e.g., letters from ABA, Brian Foley & Company, Inc., Compensia, Davis Polk and Frederic W. Cook & Co., Inc. ("Frederic Cook").

ownership interest who is otherwise independent would be sufficiently independent for the purpose of serving on the compensation committee. Many commentators advocated that a significant shareholder's stock ownership alone should not preclude directors affiliated with the significant shareholder from serving on an issuer's compensation committee.⁶² A number of these commentators noted that equity ownership by directors serves to align the directors' interests with those of the shareholders with respect to compensation matters.⁶³ According to one commentator, private equity funds typically have a strong institutional belief in the importance of appropriately structured and reasonable compensation arrangements, and the directors elected by such funds are highly incentivized to rigorously oversee compensation arrangements because the funds' income, success and reputations are dependent on creating value for shareholders.⁶⁴ This commentator also noted that, while private equity funds may seek to create shareholder value by strengthening or replacing the management team of a portfolio company, such funds rarely appoint partners or employees of their affiliated private equity firms to serve as executives of portfolio companies.⁶⁵

One commentator did not believe that directors affiliated with large shareholders should be permitted to serve on compensation committees, noting that situations could arise where the director's obligation to act in the best interest of all shareholders would conflict with the director's or large shareholder's own interest.⁶⁶ Two additional commentators noted that private equity and venture capital firms may engage in significant transactions with an issuer, and urged

⁶² See, e.g., letters from ABA, AFSCME, Bhagat, CEC, Davis Polk, Debevoise, Robert J. Jackson ("Jackson"), the Private Equity Growth Capital Council ("PEGCC") and SCSGP.

⁶³ See, e.g., letters from CEC and Davis Polk.

⁶⁴ See letter from PEGCC.

⁶⁵ See id.

⁶⁶ See letter from Barnard.

that all ties to the company be considered in evaluating the independence of directors affiliated with significant shareowners.⁶⁷

Our proposed rule would require the exchanges to consider current relationships between the issuer and the compensation committee member, and we requested comment on whether relationships prior to a director's appointment to the compensation committee or, for directors already serving as compensation committee members when the new listing standards take effect, prior to the effective date of the new listing standards, should also be considered. Only two commentators expressed support for establishing any such "look-back" period.⁶⁸ One commentator, although not supporting a look-back period, believed that the decision of whether to require one should be determined not by the Commission but by the exchanges.⁶⁹ Other commentators argued that a look-back period was not necessary because the two largest exchanges (NYSE and Nasdaq) currently impose look-back requirements on listed issuers in their standards regarding director independence.⁷⁰

c. Final Rule

After consideration of the comments, we are adopting the requirements as proposed, except that we are also extending them to apply to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. Under the final rule, the exchanges will be directed to establish listing standards requiring each member of a listed issuer's compensation committee to be a member of the board of directors and to be independent. The final rule does not require that

⁶⁷ See letters from AFSCME and UAW.

⁶⁸ See letters from Better Markets and CFA.

⁶⁹ See letter from Davis Polk.

⁷⁰ See letters from ABA and CEC.

exchanges establish a uniform definition of independence. We believe this approach is consistent with the mandate in Section 10C(a)(3). Further, 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 Rule 10C-1(b)(1). Although this provides the exchanges with flexibility to develop the appropriate independence requirements, as discussed below, the independence requirements developed by the exchanges will be subject to review and final Commission approval pursuant to Section 19(b) of the Exchange Act.

In developing their own definitions of independence applicable to compensation committee members, the exchanges will be required to consider relevant factors, including, but not limited to:

- a director's source of compensation, including any consulting, advisory or compensatory fee paid by the issuer; and
- whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

The final rule does not specify any additional factors that the exchanges must consider in determining independence requirements for compensation committee members, nor does the final rule prescribe any standards or relationships that will automatically preclude a finding of independence. Because the rule's relevant factors cover the same matters as the prohibitions in Section 10A(m)'s definition of audit committee independence, we expect the exchanges to consider whether those prohibitions should also apply to compensation committee members. However, consistent with Section 10C, the exchanges are not required to adopt those

prohibitions in their requirements and will have flexibility to consider other factors in developing their requirements.

As noted above and in the Proposing Release, Section 10C of the Exchange Act does not require that the exchanges prohibit all affiliates from serving on a compensation committee. 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. However, in response to concerns noted by some commentators that significant shareholders may have other relationships with listed companies that would result in such shareholders' interests not being aligned with those of other shareholders, we emphasize that it is important for exchanges to consider other ties between a listed issuer and a director, in addition to share ownership, that might impair the director's judgment as a member of the compensation committee. For example, the exchanges might conclude that personal or business relationships between members of the compensation committee and the listed issuer's executive officers should be addressed in the definition of independence.⁷¹

Although each exchange must consider affiliate relationships in establishing a definition of compensation committee independence, there is no requirement to adopt listing standards precluding compensation committee membership based on any specific relationships.

Accordingly, we do not believe it is necessary to separately define the term "affiliate" for purposes of Rule 10C-1. In addition, the final rule does not impose any required look-back

⁷¹ As the NYSE Listed Company Manual observes, "the concern is independence from management." See Commentary to NYSE Rule 303A.02(a). See also the Commentary to NYSE Rule 303A.02(a), which discusses the wide range of circumstances that could signal conflicts of interest or that might bear on the materiality of the relationship between the director and the issuer.

periods that must be incorporated in exchange listing standards relating to the independence of compensation committee members. We agree with commentators that the determination of whether to impose a look-back period in evaluating compensation committee member independence should be left to the exchanges and note that the exchanges already incorporate various look-back periods in their general criteria for director independence. In this respect, the final rule is similar to Exchange Act Rule 10A-3, which did not impose a mandatory look-back period for evaluating audit committee member independence in light of look-back periods already required by the exchanges for evaluating director independence generally.

Consistent with the proposal, the exchanges' definitions of independence for compensation committee members will be implemented through proposed rule changes that the exchanges will be required to file pursuant to Section 19(b) of the Exchange Act, which are subject to the Commission's review and approval.⁷² Consistent with the proposal, Rule 10C-1(a)(4) will require that each proposed rule change submission include, in addition to any other information required under Section 19(b) of the Exchange Act and the rules thereunder: a review of whether and how the proposed listing standards satisfy the requirements of the final rule; a discussion of the exchange's consideration of factors relevant to compensation committee independence; and the definition of independence applicable to compensation committee members that the exchange proposes to adopt or retain in light of such review.⁷³ The

⁷² The standard of review for approving proposed exchange listing standards is found in Section 19(b)(2)(C) of the Exchange Act, which provides that "[t]he Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations issued under this title that are applicable to such organization." Under Section 6(b) of the Exchange Act, the rules of an exchange must be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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."

⁷³ A submission would be required even if an exchange believes that its existing rules satisfy the requirements of Rule 10C-1. In such a circumstance, the exchange's rule submission would explain how the exchange's existing

Commission will then consider, prior to final approval, whether the exchanges considered the relevant factors outlined in Section 10C(a) and whether the exchanges' proposed rule changes are consistent with the requirements of Section 6(b) and Section 10C of the Exchange Act.

3. Authority to Retain Compensation Advisers; Responsibilities; and Funding

Section 10C(c)(1) of the Exchange Act provides that the compensation committee of a listed issuer may, in its sole discretion, retain or obtain the advice of a “compensation consultant,”⁷⁴ and Section 10C(d) extends this authority to “independent legal counsel and other advisers.”⁷⁵ Both sections also provide that the compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of compensation advisers. Sections 10C(c)(1)(C) and 10C(d)(3) provide that the compensation committee’s authority to retain, and responsibility for overseeing the work of, compensation advisers may not be construed to require the compensation committee to implement or act consistently with the advice or recommendations of a compensation adviser or to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of its duties. To ensure that the listed issuer’s compensation committee has the necessary funds to pay for such advisers, Section 10C(e) provides that a listed issuer shall provide “appropriate funding,” as determined by the compensation committee, for payment of “reasonable compensation” to compensation advisers.⁷⁶

We proposed Rules 10C-1(b)(2) and (3) to implement these statutory requirements. We are adopting these requirements substantially as proposed.

rules satisfy the requirements of Rule 10C-1, and the submission would be subject to the Commission’s review and approval.

⁷⁴ See Exchange Act Section 10C(c)(1).

⁷⁵ See Exchange Act Section 10C(d)(1).

⁷⁶ See Exchange Act Section 10C(e).

a. Proposed Rule

Proposed Rule 10C-1(b)(2) would implement Sections 10C(c)(1) and (d) by repeating the provisions set forth in those sections regarding the compensation committee’s authority to retain or obtain a compensation adviser, its direct responsibility for the appointment, compensation and oversight of the work of any compensation adviser, and the related rules of construction. In addition, proposed Rule 10C-1(b)(3) would implement Section 10C(e) by repeating the provisions set forth in that section regarding the requirement to provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.

In the Proposing Release, we noted that while the statute provides that compensation committees of listed issuers shall have the express authority to hire “independent legal counsel,” the statute does not require that they do so. Similar to our interpretation⁷⁷ of Section 10A(m) of the Exchange Act, which gave the audit committee authority to engage “independent legal counsel,”⁷⁸ we do not construe the requirements related to independent legal counsel and other advisers as set forth in Section 10C(d)(1) of the Exchange Act as requiring a compensation committee to retain independent legal counsel or as precluding a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

b. Comments on the Proposed Rule

⁷⁷ See Standards Relating to Listed Company Audit Committees, Release No. 33-8220 (Apr. 9, 2003) [68 FR 18788], n. 114 (“As proposed, the requirement does not preclude access to or advice from the company’s internal counsel or regular outside counsel. It also does not require an audit committee to retain independent counsel.”).

⁷⁸ See Exchange Act Section 10A(m)(5) (“Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.”).

Many commentators expressed general support for the proposed requirements.⁷⁹ While several commentators suggested that compensation committees should use, or be permitted to use, only independent compensation advisers,⁸⁰ other commentators agreed with the interpretive position expressed in the Proposing Release that the statute does not require a compensation committee to retain independent legal counsel or preclude the compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or counsel retained by the issuer or management.⁸¹ One commentator noted that the proposed rule should not be interpreted to “apply to or interfere with a compensation committee’s dealings with legal counsel from whom it may obtain advice, but which was not retained or selected by the committee, such as in-house and company counsel. Thus, the proposed language...should be clear that the requirement that independent legal counsel and other advisers be subject to the direct oversight of the compensation committee applies only to such counsel and advisors who are specifically and separately retained by the compensation committee.”⁸² This commentator thought it would be helpful to include the Commission’s interpretation of the statute in the text of the rule,⁸³ although one commentator viewed such clarification as unnecessary.⁸⁴ One commentator asked that we clarify whether the interpretive view expressed in the Proposing

⁷⁹ See, e.g., letters from Barnard, CalSTRS, Davis Polk, Pfizer and SCSGP.

⁸⁰ See letters from AFL-CIO, Better Markets, CalPERS, CFA Institute, CII, FLSBA and Railpen.

⁸¹ See, e.g., letters from ABA, CEC (noting that “the compensation committee is in the best position to determine whether a particular advisor would be an appropriate advisor following a review of all factors and subject to appropriate disclosure”) and Merkl.

⁸² See letter from ABA.

⁸³ See id.

⁸⁴ See letter from Merkl.

Release would apply equally to compensation consultants – i.e., whether a compensation committee could obtain advice from compensation consultants retained by management.⁸⁵

We asked for comment on whether we should define what constitutes an “independent legal counsel.” One commentator stated, without explanation, that it would not be necessary for us to define what constitutes an “independent legal counsel.”⁸⁶ Another commentator believed that we should provide more guidance for issuers to determine whether legal counsel is “independent,” so that listed issuers would have greater assurance that they are in compliance with Exchange Act Section 10C(d)(1).⁸⁷

c. Final Rule

We are adopting the rule substantially as proposed, with modifications to clarify that the scope of the requirements is limited to only those compensation advisers retained by the compensation committee and to apply the requirement that the compensation committee be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. Under the final rules, the exchanges will be directed to adopt listing standards that provide that:

- the compensation committee may, in its sole discretion, retain or obtain the advice of a compensation adviser;
- the compensation committee, which for this purpose includes those members of a listed issuer’s board of directors who oversee executive compensation matters on

⁸⁵ See letter from Carl Struby.

⁸⁶ See letter from Merkl.

⁸⁷ See letter from Robert M. Fields (Apr. 6, 2011)(“Fields”).

behalf of the board of directors in the absence of a board committee, shall be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee; and

- each listed issuer must provide for appropriate funding for payment of reasonable compensation, as determined by the compensation committee, to any compensation adviser retained by the compensation committee.

Consistent with Sections 10C(c)(1)(c) and 10C(d)(3), the final rule may not be construed to require the compensation committee to implement or act consistently with the advice or recommendations of any adviser to the compensation committee or to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

Consistent with our interpretation of Section 10C, the final rule does not require compensation committees to retain or obtain advice only from independent advisers. A listed issuer's compensation committee may receive advice from non-independent counsel, such as in-house counsel or outside counsel retained by management, or from a non-independent compensation consultant or other adviser, including those engaged by management. The final rule does not require a compensation committee to be directly responsible for the appointment, compensation or oversight of compensation advisers that are not retained by the compensation committee, such as compensation consultants or legal counsel retained by management. Rather, the direct responsibility to oversee compensation advisers applies only to those advisers retained by a compensation committee, and the obligation of the issuer to provide for appropriate funding applies only to those advisers so retained. Finally, in light of the provisions of our final rule and the fact that commentators did not urge us to define "independent legal counsel," we do not

believe such a definition is needed.⁸⁸ We note that the final rule requires the payment of reasonable compensation not only to independent legal counsel but also to “any other adviser” to the compensation committee, which includes any compensation advisers retained by the compensation committee, such as attorneys and consultants, whether or not they are independent.

4. Compensation Adviser Independence Factors

Section 10C(b) of the Exchange Act provides that the compensation committee of a listed issuer may select a compensation adviser only after taking into consideration the five independence factors specified in Section 10C(b) as well as any other factors identified by the Commission. In accordance with Section 10C(b), these factors would apply to the selection of compensation consultants, legal counsel and other advisers to the committee. The statute does not require a compensation adviser to be independent, only that the compensation committee of a listed issuer consider the enumerated independence factors before selecting a compensation adviser. Section 10C(b)(2) specifies that the independence factors identified by the Commission must be competitively neutral⁸⁹ and include, at minimum:

- The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;

⁸⁸ Similarly, Exchange Act Rule 10A-3 provides that audit committees must have the authority to engage “independent counsel” and that listed issuers must provide for appropriate funding of such advisers. Independent counsel is not further defined in Rule 10A-3, and we do not believe that there has been any uncertainty arising from the absence of such a definition.

⁸⁹ Although there is no relevant legislative history, we assume this requirement is intended to address the concern expressed by the multi-service compensation consulting firms that the disclosure requirements the Commission adopted in 2009 are not competitively neutral because they do not address potential conflicts of interest presented by boutique consulting firms that are dependent on the revenues of a small number of clients. See letter from Towers Perrin, commenting on Proxy Disclosure and Solicitation Enhancements, Release No. 33-9052 (July 10, 2009), available at <http://www.sec.gov/comments/s7-13-09/s71309-90.pdf>. The list of independence factors in Section 10C(b)(2), which addresses both multi-service firm “other services” conflicts and boutique firm “revenue concentration” conflicts, is consistent with this assumption.

- 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;
- 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;
- Any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee; and
- Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser.

We proposed to direct the exchanges to adopt listing standards requiring the compensation committee of a listed issuer to consider the five factors enumerated in Section 10C(b) of the Exchange Act prior to selecting a compensation adviser. We are adopting the rule substantially as proposed, but with some changes in response to comments.

a. Proposed Rule

Proposed Rule 10C-1(b)(4) would direct the exchanges to adopt listing standards that require the compensation committee of a listed issuer to take into account the five factors identified in Section 10C(b)(2), in addition to any other factors identified by the relevant exchange, before selecting a compensation adviser. Under the proposed rule, the exchanges would have the ability to add other independence factors that must be considered by compensation committees. In the Proposing Release, we stated that we did not propose any additional factors because we believed that the factors set forth in Section 10C(b) are “generally comprehensive,” although we solicited comment as to whether there are any additional

independence factors that should be taken into consideration by a listed issuer's compensation committee.⁹⁰

As noted above and in the Proposing Release, Section 10C does not require compensation advisers to be independent – only that the compensation committee consider factors that may bear upon independence. As a result, we did not believe that it would be appropriate to establish bright-line or numerical thresholds that would affect whether or when the factors listed in Section 10C, or any additional factors, must be considered by a compensation committee. For example, we did not believe that our rules should provide that a compensation committee must consider stock owned by an adviser only if ownership exceeds a specified minimum percentage of the issuer's stock, or that a committee must consider the amount of revenues that the issuer's business represents for an adviser only if the percentage exceeds a certain percentage of the adviser's revenues. Accordingly, proposed Rule 10C-1(b)(4) would require the listing standards developed by the exchanges to include the independence factors set forth in the statute and incorporated into the rule without any materiality or bright-line thresholds or cutoffs.⁹¹

b. Comments on the Proposed Rule

Comments on this proposal were mixed. A number of commentators supported directing the exchanges to adopt listing standards that require the compensation committee to take into account the five factors enumerated in Section 10C, in addition to any other factors identified by the exchanges.⁹² One multi-service compensation consulting firm believed that the five factors listed in Section 10C(b)(2) were, in total, competitively neutral, but that, on an individual basis,

⁹⁰ See Proposing Release, 76 FR at 18972.

⁹¹ As noted above, the exchanges would have the ability to add other independence factors that must be considered by compensation committees, and these additional factors could include materiality or bright-line thresholds or cutoffs.

⁹² See, e.g., letters from ABA, Pfizer, SCSGP and USS.

some of the factors were not competitively neutral.⁹³ This commentator suggested that we should provide an instruction to the final rules to emphasize that the factors should be considered in their totality and that no one factor should be viewed as a determinative factor of independence. Another commentator argued that the full effects of any independence factor on competition in the rapidly evolving advisory industry are not entirely knowable, and that the Commission should generally recommend factors that, when applied equally across the full spectrum of existing firms, help in achieving the goal of adviser independence.⁹⁴

Several commentators argued that some or all of the five factors identified in Section 10C(b)(2) and included in the proposed rule were not competitively neutral.⁹⁵ Multi-service consulting firms argued that the consideration of other services provided to the issuer by the person that employs the compensation consultant was not competitively neutral as this factor would affect only multi-service firms. For their part, smaller consulting firms argued that the consideration of the amount of fees received from the issuer as a percentage of a firm's total revenues was not competitively neutral because the likelihood of revenue concentration would be greater in smaller firms.⁹⁶ Three commentators argued that our existing compensation consultant fee disclosure requirements disproportionately affect multi-service consulting firms, and suggested that we could improve the competitive neutrality of our rules by requiring competitively neutral disclosure of fees paid to all compensation consultants or advisers.⁹⁷

⁹³ See letter from Aon Hewitt (“AON”).

⁹⁴ See letter from Hodak Value Advisors.

⁹⁵ See, e.g., letters from Frederic Cook, Longnecker & Associates (“Longnecker”), Mercer, Steven Hall & Partners (“Steven Hall”) and Towers Watson (“Towers”).

⁹⁶ See letters from Frederic Cook and Longnecker.

⁹⁷ See letters from AON, Mercer and Towers.

Many commentators urged us to add more independence factors to the list of factors that could affect the independence of a compensation adviser.⁹⁸ Several commentators argued that we should include a comparison of the amount of fees received for providing executive compensation consulting services to the amount of fees received for providing non-executive compensation consulting services.⁹⁹ Other commentators expressed support for requiring compensation committees to consider any business or personal relationship between an executive officer of the issuer and an adviser or the person employing the compensation adviser.¹⁰⁰ Some commentators, however, opposed adding new factors to the list of factors identified in the proposed rule,¹⁰¹ although one of these commentators acknowledged that it would advise any compensation committee evaluating the independence of a potential adviser to consider the business and personal relationships between the issuer's executive officers and the adviser or adviser's firm.¹⁰²

In the Proposing Release, we requested comment on the application of the independence factors to different categories of advisers. Several commentators requested that we stipulate that a compensation committee conferring with or soliciting advice from the issuer's in-house or outside legal counsel would not be required to consider the independence factors with respect to

⁹⁸ See, e.g., letters from ABA, AFL-CIO, AFSCME and USS.

⁹⁹ See letters from AFL-CIO, AFSCME, Frederic Cook and UAW. See also letter from Steven Hall (noting that the "requirement that a compensation committee consider the company's fees paid to a firm as a percentage of the firm's overall fees seems to overlook the more significant issue of the amount of fees the consulting firm receives for services to the compensation committee as a percentage of the total fees the firm receives including fees for other services to the company").

¹⁰⁰ See, e.g., letters from ABA (supporting consideration of relationships between adviser's employer and issuer's executive officers), Better Markets, Merkl (supporting consideration of relationships between either adviser or adviser's employer and issuer's executive officers), and USS (supporting consideration of relationships between adviser and issuer's executive officers). One commentator supported requiring consideration of business or personal relationships between an issuer's executive officers and the compensation adviser, but not the adviser's employer. See letter from Towers.

¹⁰¹ See, e.g., letters from AON, Meridian Compensation Partners ("Meridian"), SCSGP and Steven Hall.

¹⁰² See letter from Steven Hall.

such counsels.¹⁰³ These commentators believed that a compensation committee should be required to consider the independence factors only when the committee itself selects a compensation adviser, but not when it receives advice from, but does not select, an adviser.¹⁰⁴ Moreover, two of these commentators questioned the usefulness of the independence assessment as it relates to in-house legal counsel, outside legal counsel to an issuer or a compensation adviser retained by management, as they are not held out, or considered by the compensation committee, to be independent.¹⁰⁵

On the other hand, a number of commentators argued that the compensation adviser independence requirements should apply to any legal counsel that provides advice to the compensation committee.¹⁰⁶ One of these commentators argued that the language of Section 10C(b)(1) is unambiguous and that the final rules should clarify that exchange listing standards must require compensation committees to consider the independence factors whenever a committee receives advice from legal counsel, regardless of whether or not the committee selected counsel.¹⁰⁷

We also requested comment on whether we should include materiality, numerical or other thresholds that would limit the circumstances in which a compensation committee is required to consider the independence factors. Several commentators opposed including such materiality, numerical or other bright-line thresholds in the rule.¹⁰⁸ These commentators expressed concern that such thresholds may not be competitively neutral and could reduce the

¹⁰³ See letters from ABA, Davis Polk, McGuire Woods and S&C.

¹⁰⁴ See letters from ABA and McGuire Woods.

¹⁰⁵ See letters from ABA and S&C.

¹⁰⁶ See, e.g., letters from Better Markets, Robert M. Fields (Apr. 29, 2011), Richard Thalheimer and Towers.

¹⁰⁷ See letter from Towers.

¹⁰⁸ See letters from Longnecker, McGuireWoods, Meridian, SCSGP and Towers.

flexibility compensation committees have to select advisers best-suited to the issuer. A number of commentators supported a materiality threshold with respect to the stock ownership factor. One commentator suggested that consideration of this factor should be required only if an individual beneficially owns in excess of 5% of an outstanding class of an issuer's equity securities.¹⁰⁹ Another commentator suggested a threshold of \$50,000 in fair market value or 5,000 shares of a listed issuer's stock, below which an adviser's stock ownership would not be deemed to affect his or her independence.¹¹⁰ Other commentators suggested that compensation committees should be required to consider only stock owned by the lead adviser and not stock owned by other employees on the adviser's team.¹¹¹

Comments were mixed as to whether the final rule should clarify the phrases "provision of other services" or "business or personal relationships," as used in proposed Rule 10C-1(b)(4). Some commentators thought no further clarification of the phrase "provision of other services" was necessary,¹¹² and another commented that it "is better to have a general principle than to have exhaustive detailed rules that may leave loopholes for services that may impair the independence of an advisory firm."¹¹³ Two commentators suggested defining the phrase to expressly exclude certain services.¹¹⁴ For example, one commentator suggested excluding advice related to broad-based, non-discriminatory plans or surveys.¹¹⁵

¹⁰⁹ See letter from Steven Hall.

¹¹⁰ See letter from ABA.

¹¹¹ See letters from AON and Mercer.

¹¹² See letters from AON and Towers.

¹¹³ See letter from Merkl.

¹¹⁴ See letters from Hodak and Mercer.

¹¹⁵ See letter from Mercer.

Some commentators urged that we further define the phrase “business or personal relationship.”¹¹⁶ One commentator suggested that we should define “business relationship” to expressly exclude any non-commercial relationship between an adviser and a member of the issuer’s compensation committee, provided that such relationship does not result in significant monetary or economic gain to either party, and that we should define “personal relationship” to include only familial relationships.¹¹⁷ Another commentator argued that business or personal relationships that are more casual in nature may not be relevant to adviser independence and suggested limiting consideration of such relationships to those that would “more likely than not” have a “material adverse effect” on an individual’s independence.¹¹⁸ Two commentators thought it would be helpful if we provided examples of the types of relationships to be considered, in order to guide compensation committees as they consider the breadth of possible relationships that might impair adviser independence.¹¹⁹ Another commentator thought it was unnecessary for us to further define the phrase because the “myriad possible definitions and considerations are unlikely to be fully encompassed by such a definition.”¹²⁰

A few commentators also urged that we clarify the scope of individuals whose relationships would need to be considered in the context of evaluating adviser independence. One commentator recommended limiting the required consideration to the individual adviser who renders services to the compensation committee,¹²¹ and another commentator similarly recommended limiting the required consideration to the lead consultant, counsel or adviser to the

¹¹⁶ See, e.g., letters from AON and Meridian.

¹¹⁷ See letter from Meridian.

¹¹⁸ See letter from AON.

¹¹⁹ See letters from Merkl and Towers.

¹²⁰ See letter from Mercer.

¹²¹ See letter from Meridian.

committee, but not to other members of the adviser's team serving the compensation committee.¹²²

We requested comment on whether we should require disclosure of a compensation committee's process for selecting advisers. Many commentators criticized this idea, citing concerns about extending already lengthy proxy statement discussions of executive compensation and expressing doubt that additional disclosure of the process for selecting advisers would provide any useful information to investors.¹²³ However, some commentators thought such disclosure could be useful in providing transparency as to whether compensation committees were following the required process for selecting advisers.¹²⁴

c. Final Rule

After considering the comments, we are adopting the requirements substantially as proposed, but with some revisions. As discussed above, this aspect of the final rule will also apply to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. We have also decided to include one additional independence factor that compensation committees must consider before selecting a compensation adviser. Under the final rule, the exchanges will be directed to adopt listing standards that require a compensation committee to take into account the five factors enumerated in Section 10C(b)(2), as well as any business or personal relationships between the executive officers of the issuer and the compensation adviser or the person employing the adviser. This would include, for example, situations where the chief executive officer of an issuer and the compensation adviser have a familial relationship or where

¹²² See letter from Mercer (noting that the more junior members of the team rarely interact directly with the compensation committee).

¹²³ See, e.g., letters from CFA Institute and Frederic Cook.

¹²⁴ See, e.g., letter from Better Markets.

the chief executive officer and the compensation adviser (or the adviser's employer) are business partners. We agree with commentators who stated that business and personal relationships between an executive officer and a compensation adviser or a person employing the compensation adviser may potentially pose a significant conflict of interest that should be considered by the compensation committee before selecting a compensation adviser.¹²⁵

As was proposed, the final rule does not expand the stock ownership factor to require consideration of stock owned by the person employing a compensation adviser. As we noted in the Proposing Release, we interpret "any stock of the issuer owned by the compensation consultant, legal counsel, or other adviser" to include shares owned by the individuals providing services to the compensation committee and their immediate family members.

Other than the additional factor described above, the final rules will not require the listing standards to mandate consideration of independence factors beyond those set forth in Section 10C(b)(2). We believe that these six factors, when taken together, are competitively neutral, as they will require compensation committees 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. We agree with the commentator who suggested that the factors should be considered in their totality and that no one factor should be viewed as a determinative factor of independence.¹²⁶ We do not believe it is necessary, however, to provide an instruction to this effect, as the final rule directs the exchanges to require consideration of all of the specified factors. In response to concerns echoed by a number of commentators, we emphasize that neither the Act nor our final rule requires a compensation adviser to be independent, only that the

¹²⁵ See, e.g., letters from ABA, Better Markets, Merkl and USS.

¹²⁶ See letter from AON.

compensation committee consider the enumerated independence factors before selecting a compensation adviser. Compensation committees may select any compensation adviser they prefer, including ones that are not independent, after considering the six independence factors outlined in the final rule.¹²⁷

In response to comments,¹²⁸ we are including an instruction to the final rule to provide that a compensation committee need not consider the six independence factors before consulting with or obtaining advice from in-house counsel. Commentators noted that it is routine for in-house counsel to consult with, and provide advice to, the compensation committee on a variety of issues, such as, for example, the terms of an existing benefit plan or how a proposed employment contract would interrelate with other company agreements.¹²⁹ We agree with these commentators that, as in-house legal counsel are company employees, they are not held out to be independent. In addition, we do not believe compensation committees consider that in-house counsel serve in the same role or perform a similar function as a compensation consultant or outside legal counsel.

This instruction will not affect the obligation of a compensation committee to consider the independence of outside legal counsel or compensation consultants or other advisers retained by management or by the issuer. We believe that information gathered from an independence assessment of these categories of advisers will be useful to the compensation committee as it considers any advice that may be provided by these advisers. In addition, excluding outside legal counsel or compensation consultants retained by management or by the issuer from the required independence assessment may not be competitively neutral, since, as some

¹²⁷ The listing standards do not, of course, override any duties imposed on directors by applicable state law relating to the selection of compensation advisers.

¹²⁸ See letters from ABA, Davis Polk and S&C.

¹²⁹ See letters from Davis Polk and S&C.

commentators pointed out, they often perform the same types of services as the law firms and compensation consultants selected by the compensation committee.¹³⁰ Accordingly, we are including an instruction to the final rule that provides that a listed issuer's compensation committee is required to conduct the independence assessment outlined in Rule 10C-1(b)(4) with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

The final rule, like our proposal, does not include any materiality, numerical or other thresholds that would narrow the circumstances in which a compensation committee is required to consider the independence factors specified in the rule. We are concerned that adding materiality or other bright-line thresholds may not be competitively neutral. The absence of any such thresholds means that all facts and circumstances relevant to the six factors will be presented to the compensation committee for its consideration of the independence of a compensation adviser, and not just those factors that meet a prescribed threshold. For similar reasons, the final rule does not further define the phrases "provision of other services" or "business or personal relationship."

Consistent with the proposed rule, the final rule does not require listed issuers to describe the compensation committee's process for selecting compensation advisers pursuant to the new listing standards. We are sensitive to the concerns of commentators that adding such disclosure would increase the length of proxy statement disclosures on executive compensation without necessarily providing additional material information to investors.

5. Opportunity to Cure Defects

¹³⁰ See letters from Jackson and Towers.

Section 10C(f)(2) of the Exchange Act specifies that our rules must provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that would be the basis for a prohibition of the listing of an issuer's securities as a result of its failure to meet the requirements set forth in Section 10C, before imposition of such prohibition.¹³¹ To implement this requirement, we proposed Rule 10C-1(a)(3), which would require the exchanges to establish such procedures if their existing procedures are not adequate. We are adopting the rule as proposed.

a. Proposed Rule

Proposed Rule 10C-1(a)(3) would provide that the exchange listing standards required by Rule 10C-1 must allow issuers a reasonable opportunity to cure violations of the compensation committee listing requirements. The proposed rule did not set forth specific procedures for curing violations of compensation committee listing requirements, but specified that the listing standards may provide that if a member of a compensation committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable exchange, may remain a compensation committee member of the listed issuer until the earlier of the next annual shareholders' meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent. Proposed Rule 10C-1(a)(3) was patterned after similar provisions contained in Exchange Act Rule 10A-3(a)(3).¹³²

b. Comments on the Proposed Rule

Commentators generally supported proposed Rule 10C-1(a)(3). Two commentators favored requiring the exchanges to provide issuers the same opportunity to cure non-compliance

¹³¹ See Exchange Act Section 10C(f)(2).

¹³² 17 CFR 240.10A-3(a)(3).

with the compensation committee listing requirements as they have with respect to audit committee requirements.¹³³ In response to our request for comment on whether we should direct the exchanges to adopt specific procedures for curing non-compliance, several commentators were opposed to requiring the exchanges to establish any such specific procedures.¹³⁴ One commentator, however, urged us to direct the exchanges to establish more limited procedures for curing defects.¹³⁵

We also requested comment as to whether listed issuers that have just completed initial public offerings should be given additional time to comply with the compensation committee independence requirements, as is permitted by Exchange Act Rule 10A-3(b)(1)(iv)(A) with respect to audit committee independence requirements. Several commentators supported providing newly listed issuers with additional time to comply with the compensation committee listing requirements.¹³⁶ The NYSE argued that the exchanges should have the flexibility to permit an issuer applying for listing in connection with an initial public offering to have additional time to comply with compensation committee requirements.¹³⁷ The NYSE also requested that we clarify that the authority the exchanges would have under Rule 10C-1(a)(3) to provide issuers an opportunity to cure defects is not limited to situations where a previously independent compensation committee member loses his or her independent status for reasons outside his or her control.¹³⁸

c. Final Rule

¹³³ See letters from Debevoise and CalPERS.

¹³⁴ See, e.g., letters from Davis Polk and Merkl.

¹³⁵ See letter from Better Markets.

¹³⁶ See, e.g., letters from ABA, Davis Polk, Merkl and NYSE.

¹³⁷ See letter from NYSE.

¹³⁸ See id.

After consideration of the comments, we are adopting Rule 10C-1(a)(3) as proposed. Similar to Exchange Act Rule 10A-3(a)(3), the final rule requires the exchanges to provide appropriate procedures for listed issuers to have a reasonable opportunity to cure any noncompliance with the compensation committee listing requirements that could result in the delisting of an issuer's securities. The exchanges' rules may also provide that if a member of a listed issuer's compensation committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable exchange, may remain a compensation committee member of the listed issuer until the earlier of the next annual shareholders' meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent. The exchanges' authority to provide issuers an opportunity to cure defects is not limited to situations where a previously independent compensation committee member loses his or her independent status for reasons outside his or her control.

As we noted in the Proposing Release, we believe that existing listing standards and delisting procedures of most of the exchanges satisfy the requirement for there to be reasonable procedures for an issuer to have an opportunity to cure any defects on an ongoing basis. Most exchanges have already adopted procedures to provide issuers with notice and opportunity for a hearing, an opportunity for an appeal and an opportunity to cure defects before their securities are delisted.¹³⁹ Nonetheless, we expect that the rules of each exchange would provide for

¹³⁹ See, e.g., NYSE Listed Company Manual Section 801-805; Nasdaq Equity Rules 5800 Series; NYSE AMEX Company Guide Section 1009 and Part 12; Chicago Board Options Exchange Rule 31.94; Chicago Stock Exchange Article 22, Rules 4, 17A, and 22; Nasdaq OMX BX Rule 4800 series; Nasdaq OMX PHLX Rule 811. Neither NYSE Arca nor the National Stock Exchange has a rule that specifically requires listed companies to be given an opportunity to submit a plan to regain compliance with corporate governance listing standards other than audit committee requirements; issuers listed on these exchanges, however, are provided notice, an opportunity for a hearing, and an opportunity for an appeal prior to delisting. See NYSE Arca Rule 5.5(m); National Stock Exchange Rule 15.7 and Chapter X.

definite procedures and time periods for compliance with the final rule requirements to the extent they do not already do so.

We have not made any modifications to Rule 10C-1(a)(3) with respect to newly listed issuers. As discussed in more detail in Section II.B.2 of this release, in accordance with Exchange Act Section 10C(f)(3), our final rule will authorize the exchanges to exempt categories of issuers from the requirements of Section 10C. We believe this authority will allow the exchanges to craft appropriate limited exceptions from the required compensation committee listing standards for newly listed and other categories of listed issuers, subject to Commission review and approval pursuant to Section 19(b) of the Exchange Act.

B. Implementation of Listing Requirements

1. Exchanges and Securities Affected

We proposed to apply the requirements of Section 10C only to exchanges that list equity securities. In addition, the proposed rule would require that the exchanges adopt listing standards in compliance with the rule only with respect to issuers with listed equity securities. Along with the exemptions contained in Section 10C, the proposed rule would also exempt security futures products and standardized options. We are adopting the rule as proposed.

a. Proposed Rule

Section 10C(a) provides that the Commission shall direct the exchanges to prohibit the listing of any “equity security” of an issuer (other than several types of exempted issuers) that does not comply with the compensation committee member independence requirements. In contrast, Section 10C(f)(1), which states generally the scope of the compensation committee and compensation adviser listing requirements, provides that the Commission shall direct the national

securities exchanges and national securities associations “to prohibit the listing of any security of an issuer that is not in compliance with the requirements of this section” (emphasis added).

The Senate-passed version of the bill did not distinguish between equity and non-equity securities, referencing only the prohibition against the listing of “any security” of an issuer not in compliance with the independence requirements.¹⁴⁰ The initial House-passed version would have required the Commission to adopt rules to direct the exchanges to prohibit the listing of “any class of equity security” of an issuer that is not in compliance with the compensation committee independence standards, as well as with any of the other provisions of that section, including the provisions relating to compensation advisers.¹⁴¹ According to a press release issued by the House Financial Services Committee, this language was added during deliberations by that committee to clarify that the compensation committee independence standards would apply only to “public companies, not to companies that have only an issue of publicly-registered debt.”¹⁴² Because the Senate-passed version of the bill (which did not specify “equity” securities) was used as the base for the conference draft, it appears that addition of “equity” securities in Section 10C(a) of the conference draft was deliberate. Unlike the House-passed bill, however, the final bill specifically references equity securities only in connection with compensation committee member independence requirements.

As we noted in the Proposing Release, the NYSE currently exempts issuers whose only listed securities are debt securities from the compensation committee listing requirements that apply to issuers listing equity securities.¹⁴³ In addition, Exchange Act Rule 3a12-11 exempts

¹⁴⁰ See H.R. 4173, 111th Cong. § 952 (as passed, with amendments, by the Senate on May 20, 2010).

¹⁴¹ See H.R. 4173, 111th Cong. § 2003 (as passed by the House of Representatives on Dec. 11, 2009).

¹⁴² See Press Release, Financial Services Committee Passes Executive Compensation Reform, July 28, 2009, available at: <http://democrats.financialservices.house.gov/press/PRArticle.aspx?NewsID=520>.

¹⁴³ See NYSE Listed Company Manual Section 303A.00.

listed debt securities from most of the requirements in our proxy and information statement rules.¹⁴⁴ Finally, most, if not all, issuers with only listed debt securities, other than foreign private issuers, are privately held.¹⁴⁵ In light of the legislative history and our and the exchanges' historical approach to issuers with only listed debt securities, we noted in the Proposing Release that we view the requirements of Section 10C as intended to apply only to issuers with listed equity securities.¹⁴⁶

Accordingly, we proposed to apply Rule 10C-1 only to exchanges that list equity securities, and to direct these exchanges to adopt listing standards implementing our rule only as to issuers that are seeking to list or have listed equity securities. We noted in the Proposing Release that proposed Rule 10C-1 would not currently apply to FINRA, the only existing national securities association registered under Section 15A(a) of the Exchange Act, as FINRA does not list any securities and does not have listing standards under its rules.¹⁴⁷ Nevertheless, as

¹⁴⁴ In adopting this rule, the Commission determined that debt holders would receive sufficient protection from the indenture, the Trust Indenture Act, the proxy rules' antifraud proscriptions, and the Exchange Act rules that facilitate the transmission of materials to beneficial owners. See Exemptive Relief and Simplification of Filing Requirements for Debt Securities To Be Listed on a National Securities Exchange, Release No. 34-34922 (Nov. 1, 1994) [59 FR 55342].

¹⁴⁵ Based on a review of information reported on Forms 10-K, 20-F and 40-F and current public quotation and trade data on issuers whose debt securities are listed on an exchange, such as the NYSE Listed and Traded Bonds and NYSE Amex Listed Bonds, we estimate that there are approximately 83 issuers that list only debt securities on an exchange. Of these 83 issuers, approximately 45 are wholly-owned subsidiaries that would be exempt from proposed Exchange Act Rule 10C-1 pursuant to Section 10C(g) of the Act. None of these 83 issuers has a class of equity securities registered under Section 12 of the Exchange Act.

¹⁴⁶ Although Section 10C is, in many respects, similar to the audit committee independence requirements contained in Section 10A(m), there are differences in some of the statutory language. In this regard, we note that the requirements included in Section 10A(m) of the Exchange Act, as set forth in Section 301 of the Sarbanes-Oxley Act, are applicable generally to "listed securities," and no reference is made to equity securities. Therefore, although Section 10A(m) applies to issuers whether they have listed debt or equity, we do not believe this should necessarily prescribe the scope of Section 10C.

¹⁴⁷ Similarly, we stated that we did not expect the National Futures Association, which is a national securities association registered under Section 15A(k) for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products, see note 8, above, to develop listing standards regarding compensation committees in compliance with proposed Rule 10C-1. See Proposing Release, 76 FR at 18974, n. 73.

Section 10C specifically references national securities associations, proposed Rule 10C-1 would apply to any registered national securities association that lists equity securities in the future.¹⁴⁸

Under proposed Rule 10C-1(a), exchanges would be required, to the extent that their listing standards did not conform with Rule 10C-1, to issue or amend their listing rules, subject to Commission review, to comply with the new rule. As noted in the Proposing Release, an exchange that lists or trades security futures products (as defined in Exchange Act Section 3(a)(56))¹⁴⁹ may register as an exchange under Section 6(g) of the Exchange Act solely for the purpose of trading those products. As the Exchange Act definition of “equity security” includes security futures on equity securities,¹⁵⁰ exchanges whose only listed equity securities are security futures products¹⁵¹ would be required to comply with Rule 10C-1 absent an applicable exemption. Given that Section 10C(f) of the Exchange Act makes no distinction between exchanges registered pursuant to Section 6(a) – such as the NYSE and Nasdaq – and those

¹⁴⁸ The OTC Bulletin Board (OTCBB) and the OTC Markets Group (previously known as the Pink Sheets and Pink OTC Markets) will not be affected by Rule 10C-1, and therefore issuers whose securities are quoted on these interdealer quotation systems similarly will not be affected, unless their securities also are listed on a national securities exchange. The OTCBB is an “interdealer quotation system” for over-the-counter securities that is operated by FINRA. (Exchange Act Rule 15c2-11 defines the term “interdealer quotation system.” 17 CFR 240.15c2-11.) It does not, however, have a listing agreement or arrangement with the issuers whose securities are quoted on the system and are not considered listed, as that term is defined and used in Rule 10C-1. See Rules 10C-1(a)(2) and (c)(3). Although market makers may be required to review and maintain specified information about an issuer and to furnish that information to FINRA, the issuers whose securities are quoted on the OTCBB are not required to submit any information to the system. The OTC Markets Group is not a registered national securities exchange or association, nor is it operated by a registered national securities exchange or association, and thus is not covered by the terms of the final rule.

¹⁴⁹ Exchange Act Section 3(a)(56) defines the term “security futures product” to mean “a security future or any put, call, straddle, option, or privilege on any security future.” 15 U.S.C. 78c(a)(56).

¹⁵⁰ Section 3(a)(11) of the Exchange Act defines the term “equity security” as any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

¹⁵¹ Exchanges currently registered solely pursuant to Section 6(g) of the Exchange Act include the Board of Trade of the City of Chicago, Inc.; the CBOE Futures Exchange, LLC; the Chicago Mercantile Exchange, Inc.; One Chicago, LLC; the Island Futures Exchange, LLC; and NQLX LLC.

registered pursuant to Section 6(g), we did not propose a wholesale exemption from the requirements of Rule 10C-1 for those exchanges registered solely pursuant to Section 6(g).

However, as discussed below, we proposed to exempt security futures products from the scope of proposed Rule 10C-1. Accordingly, we noted in the Proposing Release that, to the extent the final rule exempted the listing of security futures products from the scope of Rule 10C-1, any exchange registered solely pursuant to Section 6(g) of the Exchange Act and that lists and trades only security futures products would not be required to file a rule change in order to comply with Rule 10C-1.

We proposed to exempt security futures products and standardized options from the requirements of Rule 10C-1. Although the Exchange Act defines “equity security” to include any security future on any stock or similar security, the Commodity Futures Modernization Act of 2000 (the “CFMA”)¹⁵² permits the exchanges to trade futures on individual securities and on narrow-based security indices (“security futures”)¹⁵³ without such securities being subject to the registration requirements of the Securities Act of 1933 (the “Securities Act”) and the Exchange Act so long as they are cleared by a clearing agency that is registered under Section 17A of the Exchange Act¹⁵⁴ or that is exempt from registration under Section 17A(b)(7)(A) of the Exchange Act. In December 2002, we adopted rules that provide comparable regulatory treatment for standardized options.¹⁵⁵

¹⁵² Pub. L. No. 106-554, 114 Stat. 2763 (2000).

¹⁵³ Exchange Act Section 3(a)(56) [15 U.S.C. 78c(a)(56)], and Commodities Exchange Act Section 1a(32) [7 U.S.C. 1a(32)] define “security futures product” as a security future or any put, call, straddle, option, or privilege on any security future.

¹⁵⁴ 15 U.S.C. 78q-1.

¹⁵⁵ See Release No. 33-8171 (Dec. 23, 2002) [68 FR 188]. In that release, we exempted standardized options issued by registered clearing agencies and traded on a registered national securities exchange or on a registered national securities association from all provisions of the Securities Act, other than the antifraud provision of Section 17, as well as the Exchange Act registration requirements. Standardized options are defined in Exchange Act Rule 9b-1(a)(4) [17 CFR 240.9b-1(a)(4)] as option contracts trading on a national securities exchange, an automated

The clearing agency for security futures products and standardized options is the issuer of these securities,¹⁵⁶ but its role as issuer is fundamentally different from an issuer of equity securities of an operating company. The purchasers of security futures products and standardized options do not, except in the most formal sense, make an investment decision based on the issuer. As a result, information about the clearing agency's business, its officers and directors and its financial statements is much less relevant to investors in these securities than information about the issuer of the underlying security. Similarly, the investment risk in these securities is determined by the market performance of the underlying security rather than the results of operations or performance of the clearing agency, which is a self-regulatory organization subject to regulatory oversight. Furthermore, unlike a conventional issuer, the clearing agency does not receive the proceeds from the sales of security futures products or standardized options.¹⁵⁷

In recognition of these fundamental differences, we provided exemptions for security futures products and standardized options from the audit committee listing requirements in Exchange Act Rule 10A-3.¹⁵⁸ Specifically, Rule 10A-3(c) exempts the listing of a security futures product cleared by a clearing agency that is registered pursuant to Section 17A of the Exchange Act or that is exempt from registration pursuant to Section 17A(b)(7)(A) and the

quotation system of a registered securities association, or a foreign securities exchange which relate to option classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate.

¹⁵⁶ See Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization, Release No. 34-50699 (Nov. 18, 2004) [69 FR 71126], at n. 260 (“Standardized options and security futures products are issued and guaranteed by a clearing agency. Currently, all standardized options and security futures products are issued by the Options Clearing Corporation (‘OCC’).”).

¹⁵⁷ However, the clearing agency may receive a clearing fee from its members.

¹⁵⁸ See Exchange Act Rules 10A-3(c)(4) and (5).

listing of a standardized option issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act. For the same reasons that we exempted these securities from Rule 10A-3, we proposed to exempt these securities from Rule 10C-1.

b. Comments on the Proposed Rule

Commentators generally agreed that Section 10C should apply only to issuers with listed equity securities.¹⁵⁹ Some commentators argued that the proposed rule should apply to all domestic exchanges and public companies without exception.¹⁶⁰ These commentators did not specifically comment on whether the statute is intended to apply only to issuers with listed equity securities. One commentator recommended that we exempt only exchanges that do not list equity securities and agreed that our proposed exemption for security futures products and standardized options is necessary or appropriate in the public interest and consistent with the protection of investors.¹⁶¹

c. Final Rule

After consideration of the comments, we are adopting the proposals without change. As adopted, the final rule will:

- Require all exchanges that list equity securities, to the extent that their listing standards do not already comply with the final rule, to issue or amend their listing rules to comply with the new rule;
- Provide that exchange listing standards required by the new rule need apply only to issuers with listed equity securities; and

¹⁵⁹ See, e.g., letters from Debevoise and PEGCC.

¹⁶⁰ See letters from CII and FLSBA.

¹⁶¹ See letter from Merkl.

- Exempt security futures products cleared by a clearing agency that is registered pursuant to Section 17A of the Exchange Act or that is exempt from registration pursuant to Section 17A(b)(7)(A) and standardized options that are issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act.

2. Exemptions

Section 10C of the Exchange Act has four different provisions relating to exemptions from some or all of the requirements of Section 10C:

- Section 10C(a)(1) provides that our rules shall direct the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2), other than an issuer that is in one of five specified categories – controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act¹⁶² and foreign private issuers that disclose in their annual reports the reasons why they do not have an independent compensation committee;
- Section 10C(a)(4) provides that our rules shall authorize the exchanges to exempt a particular relationship from the independence requirements applicable to compensation committee members, as each exchange determines is appropriate, taking into consideration the size of the issuer and any other relevant factors;
- Section 10C(f)(3) provides that our rules shall authorize the exchanges to exempt any category of issuer from the requirements of Section 10C as the exchanges determine

¹⁶² 15 U.S.C. 80a-1 et seq.

- is appropriate, and that, in making such determinations, the exchanges must take into account the potential impact of the requirements on smaller reporting issuers; and
- Section 10C(g) specifically exempts controlled companies, as defined in Section 10C(g), from all of the requirements of Section 10C.

We proposed Rule 10C-1(b)(1)(iii)(A) to exempt the five categories of issuers enumerated in Section 10C(a)(1); Rule 10C-1(b)(1)(iii)(B) to authorize the exchanges to exempt a particular relationship from the independence requirements applicable to compensation committee members, as each exchange determines is appropriate, taking into consideration the size of the issuer and other relevant factors; Rule 10C-1(b)(5)(i) to permit the exchanges to exempt any category of issuer from the requirements of Section 10C, as each exchange determines is appropriate, taking into consideration the potential impact of such requirements on smaller reporting issuers; and Rule 10C-1(b)(5)(ii) to exempt controlled companies from the requirements of Rule 10C-1. We are adopting the proposals with changes made in response to comments.

a. Proposed Rule

i. Issuers Not Subject to Compensation Committee Independence Requirements

As noted above, Exchange Act Section 10C(a)(1) provides that our rules shall direct the exchanges to prohibit the listing of any equity security of an issuer, other than an issuer that is in one of five specified categories, that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2). Accordingly, we proposed to exempt controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act and foreign

private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee from these requirements.

Under Section 10C(g)(2) of the Exchange Act, a “controlled company” is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. We proposed to incorporate this definition into Rule 10C-1(c)(2). Section 10C did not define the terms “limited partnerships” or “companies in bankruptcy proceedings.” As noted in the Proposing Release, we believe that a limited partnership is generally understood to mean 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.¹⁶³ We also noted in the Proposing Release that the phrase “companies in bankruptcy proceedings” is used in several Commission rules without definition.¹⁶⁴ Accordingly, we did not further define either term in proposed Rule 10C-1(c).

Section 10C does not define the term “open-end management investment company.” As discussed in the Proposing Release, under the Investment Company Act, an open-end management investment company is an investment company, other than a unit investment trust or face-amount certificate company, that offers for sale or has outstanding any redeemable security of which it is the issuer.¹⁶⁵ We proposed to define this term in proposed Rule 10C-1(c) by referencing Section 5(a)(1) of the Investment Company Act.

¹⁶³ See Unif. Ltd. P’ship Act §§ 102, 303 and 404 (2001).

¹⁶⁴ See, e.g., Section 55(a)(3)(A) of the Investment Company Act [15 U.S.C. 80a-54(a)(3)(A)]; Item 1107(k) of Regulation AB [17 CFR 229.1107(k)]; and Rule 457 under the Securities Act [17 CFR 230.457].

¹⁶⁵ See Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a-4 and 80a-5(a)(1)]. Open-end and closed-end management investment companies registered under the Investment Company Act are generally exempt from current exchange listing standards that require listed issuers to either have a compensation committee or to have independent directors determine, recommend, or oversee specified executive compensation matters. See, e.g.,

Under Section 10C(a)(1), a foreign private issuer that provides annual disclosure to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee would be exempt from the compensation committee member independence requirements. Exchange Act Rule 3b-4 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.”¹⁶⁶ Since this definition applies to all Exchange Act rules, we did not believe it was necessary to include a cross-reference to Rule 3b-4 in our proposed rules.

In the Proposing Release, we noted that certain foreign private issuers have a two-tier board, with one tier designated as the management board and the other tier designated as the supervisory or non-management board. Similar to our approach to Rule 10A-3, proposed Rule 10C-1(b)(1)(iii) would clarify that in the case of foreign private issuers with two-tier boards of directors, the term “board of directors” means the supervisory or non-management board. Accordingly, to the extent the supervisory or non-management board forms a separate compensation committee, proposed Rule 10C-1 would apply to that committee, with the exception of the committee member independence requirements, assuming the foreign private issuer discloses why it does not have an independent compensation committee in its annual report.

ii. Exemption of Relationships and Other Categories of Issuers

NYSE Listed Company Manual Section 303A.00; Nasdaq Rule 5615(a)(5); NYSE Arca Rule 5.3; NYSE AMEX Company Guide Section 801.

¹⁶⁶ 17 CFR 240.3b-4(c).

As noted above, Section 10C(a)(4) of the Exchange Act provides that the Commission's rules shall permit an exchange to exempt a particular relationship from the compensation committee independence requirements, as such exchange deems appropriate, taking into consideration the size of the issuer and any other relevant factors. In addition, as noted above, Section 10C(f)(3) provides that our rules shall authorize an exchange to exempt a category of issuers from the requirements of Section 10C, as the exchange determines is appropriate, taking into account the potential impact of the Section 10C requirements on smaller reporting issuers. To implement these provisions, we proposed Rule 10C-1(b)(1)(iii)(B), which would authorize the exchanges to establish listing standards that exempt particular relationships between members of the compensation committee and listed issuers that might otherwise impair the member's independence, taking into consideration the size of an issuer and any other relevant factors, and Rule 10C-1(b)(5)(i), which would allow the exchanges to exempt categories of listed issuers from the requirements of Section 10C, as each exchange determines is appropriate. In determining the appropriateness of categorical issuer exemptions, the exchanges would be required, in accordance with the statute, to consider the potential impact of the requirements of Section 10C on smaller reporting issuers.¹⁶⁷

Other than the five categories of issuers in Section 10C(a)(1), we did not propose to exempt any relationship or any category of issuer from the compensation committee member independence requirements under Section 10C(a)(1). Instead of including specific exemptions,

¹⁶⁷ See Exchange Act Section 10C(f)(3)(B). Section 10C of the Exchange Act includes no express exemptions for smaller reporting companies. Some exchanges currently have limited exemptions from requirements to have a majority independent board or a three-member audit committee for smaller issuers – for example, NYSE Amex and the Chicago Stock Exchange permit smaller issuers to have a 50% independent board and a minimum of two members on the issuer's audit committee. See NYSE Amex Company Guide Section 801(h); Chicago Stock Exchange Article 22, Rules 19(a), 19(b)(1)(C)(iii), and 21(a). Section 10C(f)(3) expressly requires the exchanges to take into account the potential impact of the listing requirements on smaller reporting issuers when exercising the exemptive authority provided to them by our rules.

the proposed rule generally would leave the determination of whether to exempt particular relationships or categories of issuers to the discretion of the exchanges, subject to our review in the rule filing process. Because listed issuers frequently consult the exchanges regarding independence determinations and committee responsibilities, in the proposal we explained that we believed that the exchanges are in the best position to identify any relationships or categories of issuers that may merit exemption from the compensation committee listing requirements.

b. Comments on the Proposed Rule

Comments on the proposals were generally favorable. Commentators generally supported the proposed approach of deferring to the exchanges any decisions to exempt any categories of issuers or particular relationships that might compromise committee member independence.¹⁶⁸ One commentator expressed concern that the proposed definition of “controlled companies” would not exempt some listed issuers that are controlled companies under applicable listing standards, but do not actually hold director elections, such as some limited liability companies.¹⁶⁹ This commentator recommended that we revise the definition of “controlled companies” in proposed Rule 10C-1(c)(2) so that it would encompass companies that do not actually hold director elections but have more than 50% of the voting power for the election of directors held by an individual, a group or another company.

In the Proposing Release, we requested comment on whether we should exempt any types of issuers, such as registered management investment companies, foreign private issuers or smaller reporting companies,¹⁷⁰ from some or all of the requirements of Section 10C. The NYSE stated its view that the express exclusion of certain types of issuers in Section 10C(a)(1) should

¹⁶⁸ See, e.g., letters from NYSE and S&C.

¹⁶⁹ See letter from Vinson & Elkins LLP (“V&E”).

¹⁷⁰ See Exchange Act Rule 12b-2 for the definition of “smaller reporting company.”

not prevent an exchange from exempting other types of issuers, and urged us to clarify that the general exemptive authority exchanges would have under Rule 10C-1 is not limited to smaller reporting companies.¹⁷¹

Several commentators urged us to exempt all foreign private issuers from the requirements of Section 10C.¹⁷² Another commentator urged us to exempt smaller reporting companies from the requirements of Section 10C because smaller reporting companies may experience more difficulty than other issuers in finding independent directors who are willing to serve on their boards.¹⁷³ Other commentators, however, believed that we should not exempt foreign private issuers or smaller reporting companies from the requirements of Section 10C.¹⁷⁴ Several of these commentators supported uniform application of compensation committee independence requirements to all public companies.¹⁷⁵ One commentator believed that domestic companies should not face a stricter regime than foreign companies and suggested that foreign companies could be given a time frame within which they would be required to meet the listing standards that apply to domestic companies.¹⁷⁶

One commentator urged us to exempt all registered investment companies from the requirements of Section 10C.¹⁷⁷ This commentator noted that registered investment companies are subject to the requirements of the Investment Company Act, including, in particular, requirements concerning potential conflicts of interest related to investment adviser

¹⁷¹ See letter from NYSE.

¹⁷² See letters from ABA, Davis Polk and SAP AG.

¹⁷³ See letter from ABA.

¹⁷⁴ See letters from CalPERS, CII, FLSBA, the Local Authority Pension Fund Forum (“LAPFF”), Merkl, Railpen and USS.

¹⁷⁵ See letters from CII, FLSBA and USS.

¹⁷⁶ See letter from LAPFF.

¹⁷⁷ See letter from the Investment Company Institute (“ICI”).

compensation. The commentator also noted that most registered investment companies are externally managed, do not have compensated executives and, therefore, do not need compensation committees to oversee executive compensation.

c. Final Rule

After consideration of the comments, we are adopting the rule with revisions in response to comments. Rule 10C-1(b)(1)(iii) will exempt from the compensation committee member independence listing standards required under Rule 10C-1(a) limited partnerships, companies in bankruptcy proceedings, registered open-end management investment companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee.

As we proposed, we are also exempting controlled companies from the requirements of Rule 10C-1. In light of Section 10C(g)'s general exemption for controlled companies, we have eliminated the specific exemption for controlled companies from the compensation committee member independence listing standards in final Rule 10C-1(b)(1)(iii). We believe this specific exemption from the compensation committee member independence listing standards for controlled companies is unnecessary in light of the broader exemption for controlled companies provided by final Rule 10C-1(b)(5)(ii).

In response to comments that our proposed definition of controlled company would not exempt listed issuers that would otherwise be controlled companies but for the fact that they do not hold director elections, we are modifying the definition of controlled company in the final rule. Under the final rule, a controlled company will be defined as a listed company in which more than 50% of the voting power for the election of directors is held by an individual, a group or another company. We have removed from the definition the phrase "holds an election for the

board of directors.” The revised definition of “controlled company” will more closely follow the definition of the term currently used by the NYSE and Nasdaq.¹⁷⁸ Although the definition in the final rule is slightly broader than the definition of “controlled company” in Section 10C(g)(2), we believe this modification is consistent with the statutory intent to exempt from the requirements of Section 10C those companies that are in fact controlled by a shareholder or group of shareholders, regardless of whether director elections are actually held.

In addition to controlled companies, we are exempting smaller reporting companies, as defined in Exchange Act Rule 12b-2, from the requirements of Rule 10C-1.¹⁷⁹ As noted above, one commentator urged us to exempt smaller reporting companies from the requirements of Section 10C because smaller reporting companies may experience more difficulty than other issuers in finding independent directors who are willing to serve on their boards.¹⁸⁰ This commentator also noted that the compensation committees of smaller reporting companies often do not hire outside compensation consultants, both because their compensation programs tend to be “relatively simple” and also because smaller reporting companies “often cannot afford to hire outside experts.”¹⁸¹

We recognize that some commentators opposed such an exemption,¹⁸² but we believe, on balance, that an exemption is appropriate. In 2006, when we substantially revised our executive compensation disclosure rules, we adopted new scaled executive compensation disclosure

¹⁷⁸ See NYSE Listed Company Manual Section 303A.00 and Nasdaq Rule 5615(c).

¹⁷⁹ Approximately 1%, 25% and 53% of the operating companies listed on the NYSE, the Nasdaq Stock Market, and NYSE Amex, respectively, are smaller reporting companies. See Memorandum to File No. S7-13-11, dated May 8, 2012, concerning information on listed smaller reporting companies, which is available at <http://www.sec.gov/comments/s7-13-11/s71311-60.pdf>.

¹⁸⁰ See letter from ABA.

¹⁸¹ See *id.*

¹⁸² See letters from CalPERS, CII, FLSBA, Merkl and Railpen. These commentators did not provide specific reasons for their opposition, other than two commentators noting that the matters addressed in Section 10C are relevant to all public companies. See letters from CII and FLSBA.

requirements for smaller companies in recognition of the fact that the “executive compensation arrangements of small business issuers generally are so much less complex than those of other public companies that they do not warrant the more extensive disclosure requirements imposed on companies that are not small business issuers and related regulatory burdens that could be disproportionate for small business issuers.”¹⁸³ In light of those findings with respect to smaller reporting companies’ less complex executive compensation arrangements, we are not persuaded that the additional burdens of complying with Rule 10C-1 are warranted for smaller reporting companies.

We appreciate that these burdens for listed smaller reporting companies may not be significant given that such issuers are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under the exchanges’ general independence standards. We do believe, however, that exempting smaller reporting companies from the listing standards mandated by Rule 10C-1 can offer cost savings to these listed issuers to the extent that an exchange, in connection with the listing standards review required by Rule 10C-1, chooses to create a new independence standard for compensation committee members that is more rigorous than its existing standards – for example, a new standard could address personal or business relationships between members of the compensation committee and the listed issuer’s executive officers. Issuers subject to the exchange’s new standard may need to replace existing compensation committee members, and incur the associated costs, if the existing members do not qualify as independent under the new standard. In addition, although listed smaller reporting

¹⁸³ See Executive Compensation and Related Person Disclosure, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158], at 53192 (“2006 Executive Compensation Release”). In 2007, we adopted a new eligibility standard for “smaller reporting companies” to replace the “small business issuer” definition then found in Item 10 of Regulation S-B. See Smaller Reporting Company Regulatory Relief and Simplification, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934].

companies do not often engage outside compensation consultants, there would be cost savings to these listed issuers from not having to comply with the listing standards involving the compensation committee's engagement and oversight of compensation advisers. For example, the exchanges are required to adopt listing standards that require the compensation committee to consider the six independence factors listed in Rule 10C-1(b)(4) before selecting a compensation adviser. To comply with these listing standards, compensation committees will likely need to create procedures for collecting and analyzing information about potential compensation advisers before they can receive advice from such advisers, which would require the listed issuers to incur costs. We expect, however, that a portion of these cost savings would likely be offset by the costs that smaller reporting companies may incur to comply with the new requirement to disclose compensation consultants' conflicts of interest, which is described in Section II.C below. In light of these considerations, we do not believe it is necessary to require the exchanges to go through the process of proposing to exempt smaller reporting companies in the Section 19(b) rule filing process, since we have concluded that it is appropriate to provide this exemption in any event. Accordingly, we are exempting smaller reporting companies from the requirements of Rule 10C-1.¹⁸⁴

We are adopting Rules 10C-1(b)(1)(iii)(B) and 10C-1(b)(5)(i) substantially as proposed. Rule 10C-1(b)(1)(iii)(B) authorizes the exchanges to exempt a particular relationship from the compensation committee member independence requirements, as the exchanges deem appropriate, taking into consideration the size of the issuer and any other relevant factors. Rule 10C-1(b)(5)(i) authorizes the exchanges to exempt any category of issuers from the requirements

¹⁸⁴ When an issuer loses its smaller reporting company status, it will be required to comply with the listing standards applicable to non-smaller reporting companies. We anticipate that the exchanges will provide for a transition period for issuers that lose smaller reporting company status, similar to what they currently have for issuers that lose controlled company status. See, e.g., NYSE Listed Company Manual Section 303A.00; Nasdaq Rule 5615(c)(3).

of Section 10C,¹⁸⁵ as each exchange determines is appropriate, taking into consideration the potential impact of the requirements on smaller reporting issuers. In response to comment, we are clarifying that the final rule does not prohibit the exchanges from considering other relevant factors as well. The final rule will allow the exchanges flexibility to propose transactions or categories of issuers to exempt, subject to our review and approval under the Exchange Act Section 19(b) rule filing process. As we noted in the Proposing Release, we believe that relying on the exchanges in this manner to exercise the exemptive authority expressly granted to them under the final rules is consistent with the requirements of Section 10C and will result in more effective determinations as to the types of relationships and the types of issuers that merit an exemption.¹⁸⁶

As noted by one commentator, most registered investment companies do not have compensated employees or compensation committees.¹⁸⁷ Therefore, the requirements of Rule 10C-1, which does not itself require any issuer to have a compensation committee, will not affect most registered investment companies or impose any compliance obligations on them.¹⁸⁸ This commentator did not explain why, in the infrequent case where a registered investment company

¹⁸⁵ As noted in the Proposing Release, Rule 10C-1(b)(5)(i) does not provide the authority for the exchanges to exempt listed issuers from the disclosure requirements under Item 407 of Regulation S-K, which include Section 10C(c)(2)'s compensation consultant disclosure requirements.

¹⁸⁶ We note that the Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. (2012) (the "JOBS Act"), which was enacted on April 5, 2012, creates a new category of issuer, an "emerging growth company," under the Securities Act and the Exchange Act. See Section 2(a)(19) of the Securities Act [15 U.S.C. 77b(a)(19)]; Section 3(a)(80) of the Exchange Act [15 U.S.C. 78c(a)(80)]. An emerging growth company is defined as an issuer that had total annual gross revenues of less than \$1 billion during its most recently completed fiscal year. Existing listing standards provide no accommodation for this category of issuer, and the JOBS Act does not require that exchanges do so. The rules we are adopting will permit the exchanges to consider, subject to the Commission's review and approval, whether any exemptions from the listing standards required by Rule 10C-1 are appropriate for emerging growth companies or any other category of issuer.

¹⁸⁷ See letter from ICI.

¹⁸⁸ We do not believe that any board committee or members of the board of a registered investment company or business development company would be a "compensation committee" under Rule 10C-1 solely as a result of carrying out the board's responsibilities under Rule 38a-1 under the Investment Company Act to approve the designation and compensation of the fund's chief compliance officer. Under Rule 38a-1, the approval of a majority of the board's independent directors is required. See 17 CFR 270.38a-1(a)(4).

has compensated executives and a compensation committee (which are not addressed by Investment Company Act requirements related to investment adviser compensation), the registered investment company should be exempt from the requirements that apply to all other listed issuers with compensation committees. We believe that the exchanges are in a better position to determine the appropriate treatment of registered investment companies that have compensated executives and compensation committees, if any.

C. Compensation Consultant Disclosure and Conflicts of Interest

Section 10C(c)(2) of the Exchange Act requires that, in any proxy or consent solicitation material for an annual meeting (or a special meeting in lieu of the annual meeting), each issuer must disclose, in accordance with regulations of the Commission, whether:

- the compensation committee has retained or obtained the advice of a compensation consultant; and
- 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.

We proposed amendments to Item 407 of Regulation S-K to require issuers to include the disclosures required by Section 10C(c)(2) in any proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected.

After consideration of the comments, we are adopting a modified version of the proposal.

1. Proposed Rule

Item 407 of Regulation S-K currently requires Exchange Act registrants that are subject to the proxy rules, other than registered investment companies, to provide certain disclosures concerning their compensation committees and the use of compensation consultants. Item 407(e)(3)(iii) generally requires registrants to disclose “any role of compensation consultants in

determining or recommending the amount or form of executive and director compensation,” including:

- identifying the consultants;
- stating whether such consultants were engaged directly by the compensation committee or any other person;
- describing the nature and scope of the consultants’ assignment, and the material elements of any instructions given to the consultants under the engagement; and
- disclosing the aggregate fees paid to a consultant for advice or recommendations on the amount or form of executive and director compensation and the aggregate fees for additional services if the consultant provided both and the fees for the additional services exceeded \$120,000 during the fiscal year.¹⁸⁹

The current item excludes from the disclosure requirement any role of compensation consultants limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.¹⁹⁰

¹⁸⁹ See current Items 407(e)(3)(iii)(A) and (B) [17 CFR 229.407(e)(3)(iii)(A) and 229.407(e)(3)(iii)(B)]. Fee disclosure, however, is not required for compensation consultants that work with management if the compensation committee has retained a separate consultant. In promulgating these requirements, we recognized that, in this situation, the compensation committee may not be relying on the compensation consultant used by management, and therefore potential conflicts of interest are less of a concern. See Proxy Disclosure Enhancements, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334] (“Proxy Disclosure Enhancements Release”).

¹⁹⁰ See Item 407(e)(3)(iii). In adopting this exclusion, the Commission determined (based on comments it received on the rule proposal) that the provision of such work by a compensation consultant does not raise conflict of interest concerns that warrant disclosure of the consultant’s selection, terms of engagement or fees. See Proxy Disclosure Enhancements Release.

As we noted in the Proposing Release, the trigger for disclosure about compensation consultants under Section 10C(c)(2) is worded differently from the existing disclosure trigger under Item 407(e)(3)(iii). Under Section 10C(c)(2), an issuer must disclose whether the “compensation committee retained or obtained the advice of a compensation consultant.” By contrast, existing Item 407 requires disclosure, with limited exceptions, whenever a compensation consultant plays “any role” in determining or recommending the amount or form of executive or director compensation. Given the similarities between the disclosure required by Section 10C(c)(2) and the disclosure required by Item 407(e)(3)(iii), we proposed amendments to integrate Section 10C(c)(2)’s disclosure requirements with the existing disclosure rule. Specifically, as proposed, revised Item 407(e)(3)(iii) would include a disclosure trigger consistent with the statutory language and would, therefore, require issuers to disclose whether the compensation committee had “retained or obtained” the advice of a compensation consultant during the issuer’s last completed fiscal year. If so, the issuer would also be required to provide related disclosures describing the consultant’s assignment, any conflicts of interest raised by the consultant’s work, and how such conflicts were being addressed. In addition, our proposed rule would alter the existing consultant fee disclosure requirements to include the same disclosure trigger. We noted in the Proposing Release that we believed the practical effect of this change would be minimal, as it would be unusual for a consultant to play a role in determining or recommending the amount of executive compensation without the compensation committee also retaining or obtaining the consultant’s advice.

Our proposed integrated disclosure requirement would no longer provide an exception from the requirement to disclose the role of a compensation consultant where that role is limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in

favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular issuer or is customized based on parameters that are not developed by the consultant and about which the consultant does not provide advice. As we explained in the Proposing Release, we believed this would be “consistent with the purposes of Section 10C(c)(2), which is to require disclosure about compensation consultants and any conflicts of interest they have in a competitively neutral fashion.”¹⁹¹ Under the proposed amendments, disclosure about the compensation consultant’s role and conflicts of interest would be required even if the consultant provided only advice on broad-based plans or non-customized benchmark data. We proposed, however, that the compensation consultant fee disclosure requirements currently included in Item 407(e)(3) would continue to include exceptions for cases where a consultant’s role is limited to providing these types of services.

In order to clarify certain terms contained in Section 10C(c)(2) and used in the proposed rules, we proposed to add an instruction to Item 407(e)(3) to clarify the meaning of the phrase “obtained the advice.” The proposed instruction would provide that a compensation committee or management will have “obtained the advice” of a compensation consultant if it “has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice.” In addition, we proposed an instruction that identified the five independence factors that Section 10C requires a listed issuer’s compensation committee to consider before selecting a

¹⁹¹ See Proposing Release, 76 FR at 18980.

compensation adviser as among the factors that issuers should consider in determining whether there is a conflict of interest that may need to be disclosed.

Finally, under the proposed amendments, these disclosures would be required only in a proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected and would apply to issuers subject to our proxy rules, whether listed or not, and whether they are controlled companies or not.

2. Comments on the Proposed Rule

Comments on the proposed amendments were mixed, with the exception of our proposal to require the disclosures called for by Section 10C(c)(2) only in proxy or information statements for meetings at which directors are to be elected, which commentators generally supported.¹⁹²

Several commentators expressed general support for our proposal to require disclosure about compensation consultants' conflicts of interest.¹⁹³ Some of these commentators noted that timely disclosure of conflicts is needed to allow investors to adequately monitor compensation committee performance.¹⁹⁴ For this reason, another commentator noted that disclosure concerning compensation consultant conflicts of interest "is most appropriately required in the context of other corporate governance disclosures that are most relevant in the context of making voting decisions with respect to the election of directors."¹⁹⁵

Several commentators expressed general support for integrating the Section 10C(c)(2) disclosure requirements into the existing compensation consultant disclosure requirements contained in Item 407(e)(3)(iii) of Regulation S-K.¹⁹⁶ One of these commentators believed that a

¹⁹² See, e.g., letters from ABA, AON and Debevoise.

¹⁹³ See, e.g., letters from AFSCME, CII, FLSBA, Hermes, OPERS and UAW.

¹⁹⁴ See letters from CII and FLSBA.

¹⁹⁵ See, e.g., letter from ABA.

¹⁹⁶ See, e.g., letters from Davis Polk, Debevoise, Meridian, Pfizer and UAW.

combined rule with a single trigger for disclosure would benefit issuers and investors by simplifying the disclosure requirement and enhancing the clarity of the disclosure.¹⁹⁷ One commentator opposed integrating the disclosure requirements of Section 10C(c)(2) into Item 407(e)(3)(iii), and believed that a better approach would be to retain the existing disclosure trigger in Item 407(e)(3)(iii) and include a separate disclosure item within Item 407 to address conflict of interest disclosure requirements.¹⁹⁸ This commentator also criticized our proposed amendments because they would narrow the disclosure currently required by Item 407(e)(3)(iii) by excluding those compensation consultants that may have participated in executive compensation determinations but were not actually retained by the compensation committee.¹⁹⁹ Another commentator supported our proposal to integrate the disclosure requirements, but believed it was unnecessary to modify the wording of Item 407(e)(3)(iii) to include the “retain or obtain the advice” disclosure trigger included in the Act.²⁰⁰ This commentator noted that issuers and consulting firms had already made significant adjustments to their business practices in light of the existing Item 407(e)(3) requirements and that it would be costly and unnecessary to make additional adjustments if the wording of the existing rules is changed simply to mirror the language included in the Act.²⁰¹

A significant number of commentators expressed concern over the proposed instruction to clarify the phrase “obtained the advice.”²⁰² These commentators believed that the proposed instruction was too broad and could potentially cover director education programs, unsolicited

¹⁹⁷ See letter from Meridian.

¹⁹⁸ See letter from ABA.

¹⁹⁹ See *id.*

²⁰⁰ See letter from AON.

²⁰¹ See *id.*

²⁰² See, e.g., letters from AON, CEC, Davis Polk, Mercer, Meridian, Pearl Meyer & Partners (“Pearl Meyer”), McGuireWoods, NACD, Pfizer, SCSGP and Towers.

survey results and publications that contain executive compensation data, which they believed were not intended to be covered by Section 10C(c)(2).²⁰³ A number of these commentators recommended modifications to the instruction, including:

- excluding insubstantial or unsolicited interaction with a compensation committee;²⁰⁴
- clarifying that the phrase “obtained the advice” excludes materials prepared for management by a compensation consultant engaged by management, even if such materials are made available to the compensation committee;²⁰⁵ and
- clarifying that “advice” has not been obtained unless the compensation consultant provides a recommendation to the committee regarding the amount or form of executive compensation.²⁰⁶

A few commentators supported our proposal to require disclosure about the role of compensation consultants even where that role is limited to consulting on broad-based plans or providing non-customized benchmark information.²⁰⁷ Many more commentators, however, opposed eliminating the current disclosure exclusions under Item 407(e)(3) and recommended that we extend those disclosure exclusions to the new disclosure requirements.²⁰⁸ Some of these commentators noted that, when the disclosure exemptions in Item 407(e)(3)(iii) were adopted in December 2009, the Commission stated that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that would warrant

²⁰³ See, e.g., letters from Davis Polk, Meridian, NACD and Towers.

²⁰⁴ See, e.g., letters from Davis Polk and Meridian.

²⁰⁵ See letters from Davis Polk and Towers.

²⁰⁶ See letters from Pfizer and SCSGP.

²⁰⁷ See, e.g., letters from AFSCME and UAW.

²⁰⁸ See, e.g., letters from ABA, AON, CEC, Davis Polk, Debevoise, Meridian, SCSGP, Towers and U.S. Chamber of Commerce (Apr. 28, 2011) (“Chamber”).

disclosure of the consultant’s selection, terms of engagement or fees.²⁰⁹ Another commentator believed that retaining the existing disclosure exclusions in Item 407(e)(3)(iii) would be consistent with the purposes of Section 10C(c)(2) because a consulting firm that provided only non-customized benchmark data to a compensation committee would not be providing “advice” to the compensation committee.²¹⁰

Commentators generally supported our proposal to identify the five factors in proposed Rule 10C-1(b)(4)(i) through (v) as among the factors that should be considered in determining whether a conflict of interest exists,²¹¹ though some commentators suggested additional factors that they believed should be considered.²¹² In the Proposing Release, we requested comment on whether we should include the appearance of a conflict of interest in our interpretation of what constitutes a “conflict of interest” that must be disclosed under the proposed amendments. A few commentators believed that we should require disclosure of the appearance of a conflict of interest or potential conflicts of interest.²¹³ One of these commentators argued that including potential conflicts is necessary because actual conflicts of interest can be difficult to identify with precision.²¹⁴ Other commentators believed that we should not require disclosure of either an appearance of a conflict of interest or a potential conflict of interest, for various reasons, such as: potential conflicts were not covered by the text of Section 10C(c)(2);²¹⁵ potential conflicts would

²⁰⁹ See, e.g., letter from ABA and Davis Polk.

²¹⁰ See letter from SCSGP.

²¹¹ See letters from AON and Towers.

²¹² See, e.g., letters from AFSCME (urging consideration of the ratio between fees paid for executive compensation and non-executive compensation consulting work, as well as equity ownership and incentive compensation arrangements of consultants) and Merkl (urging consideration of private and business relationships between the person employing the adviser and executive officers or members of the compensation committee, as well as stock ownership by the person that employs the adviser, if it is material).

²¹³ See letters from Better Markets, OPERS and Towers.

²¹⁴ See letter from Better Markets.

²¹⁵ See letters from ABA, AON and Mercer.

be difficult to define and would not provide investors with additional material information regarding the compensation consultant relationship,²¹⁶ and compensation committees are not reluctant or unable to conclude that a conflict of interest exists.²¹⁷

Many commentators requested that we clarify that the amendments to Item 407(e)(3)(iii) apply only to board committees that are charged with determining executive compensation, and not to any committee of the board, if separate, that oversees the compensation of non-employee directors.²¹⁸ Several of these commentators noted that in many instances, a committee other than the company's compensation committee, such as a governance committee, determines the compensation of the company's non-executive directors.²¹⁹

We requested comment on whether we should extend the Section 10C(c)(2) disclosure requirements to compensation advisers other than compensation consultants. Comments were mixed. A number of commentators believed we should require conflicts of interest disclosure for all types of advisers, including legal counsel.²²⁰ One commentator stated that extending the disclosure requirements to legal counsel would benefit the investing public in its consideration of compensation issues.²²¹ Another commentator noted that requiring such disclosure would allow investors to determine whether the compensation committee had the benefit of independent legal advice in making compensation determinations.²²² Other commentators felt that conflicted compensation advisers of any kind could not be relied upon to serve the best interests of the

²¹⁶ See letter from ABA.

²¹⁷ See letter from AON.

²¹⁸ See, e.g., letters from CEC, Chamber, Davis Polk, Pfizer and SCSGP.

²¹⁹ See letters from CEC and Chamber.

²²⁰ See, e.g., letters from Better Markets, CII, Fields, FLSBA, Jackson and Towers.

²²¹ See letter from Fields.

²²² See letter from Jackson.

issuer and its shareholders.²²³ Two commentators opposed extending the proposed disclosure requirements to legal counsel.²²⁴ One of these commentators believed that the specific statutory reference in Section 10C(c)(2) to “compensation consultants” reflects a deliberate policy choice by Congress to limit the additional required disclosures to compensation consultants alone.²²⁵

The proposed rule would apply to issuers that are required to comply with the proxy rules. One commentator supported our proposal to require controlled companies to provide disclosures relating to compensation consultants and conflicts of interest raised by the consultants’ work.²²⁶ Three commentators were opposed to this proposed requirement,²²⁷ and one of them questioned the value of requiring disclosure of a compensation consultant’s conflicts of interest in cases where the composition of the board of directors and compensation committee is subject to the direction of a control person or group.²²⁸ One commentator supported our proposal to require smaller reporting companies to provide disclosures relating to compensation consultant conflicts of interest, noting that “[w]e are not aware of any particular problems smaller reporting companies have had with the existing rules, and we do not believe the additional rules mandated by Dodd Frank will be any more burdensome on smaller reporting companies.”²²⁹

We received few comments on our proposal to extend the disclosure requirements to Exchange Act registrants that are not listed issuers. Two commentators supported our

²²³ See letters from CII and FLSBA.

²²⁴ See letters from ABA and McGuire Woods.

²²⁵ See letter from McGuire Woods.

²²⁶ See letter from AON.

²²⁷ See letters from ABA, Debevoise and Merkl.

²²⁸ See letter from Debevoise.

²²⁹ See letter from AON.

proposal.²³⁰ One commentator who opposed the proposal believed that extending the disclosure requirements of Section 10C(c)(2) to non-listed issuers is not required by Section 10C or for the protection of investors.²³¹

Several commentators agreed that we should not amend Forms 20-F or 40-F to require foreign private issuers that are not subject to our proxy rules to provide annual disclosure of the type required by Section 10C(c)(2).²³² Two of these commentators noted that imposing such requirements would be inconsistent with the current disclosure paradigm for compensation matters, which generally defers to a foreign private issuer's home country rules.²³³ One commentator, however, expressed the view that foreign private issuers should have to comply with the same compensation consultant disclosure requirements as domestic issuers.²³⁴

3. Final Rule

After consideration of the comments, we are adopting a modified version of the proposed amendments. The amendments we are adopting implement the disclosure requirements of Section 10C(c)(2) while preserving the existing disclosure requirements under Item 407(e)(3).

a. Disclosure Requirements

Rather than integrating the new disclosure requirements with the existing compensation consultant disclosure provisions, as proposed, we are retaining the existing disclosure trigger and requirements of Item 407(e)(3)(iii) and adding a new subparagraph to Item 407(e)(3) to require the disclosures mandated by Section 10C(c)(2)(B). With respect to Section 10C(c)(2)(A), which requires an issuer to disclose whether its compensation committee retained or obtained the

²³⁰ See letters from AON and Merkl.

²³¹ See letter from Debevoise.

²³² See letters from ABA, AON, Debevoise and SAP.

²³³ See letters from Debevoise and SAP.

²³⁴ See letter from Merkl.

advice of a compensation consultant, we believe existing Item 407(e)(3)(iii) implements this disclosure requirement, as it requires disclosure, with certain exceptions discussed more fully below, of any role compensation consultants played in determining or recommending the amount or form of executive and director compensation. As we noted in the Proposing Release, we believe it would be unusual for a compensation consultant to play “any role” in determining or recommending the amount of executive compensation without the compensation committee also retaining or obtaining the compensation consultant’s advice.

With respect to the disclosures mandated by Section 10C(c)(2)(B), we are persuaded by comments noting that our proposal to use the “retain or obtain the advice” disclosure trigger included in Section 10C could result in unnecessary, and potentially costly, adjustments by issuers and consulting firms that have adapted their business practices in light of the existing Item 407(e)(3)(iii) disclosure requirements. In addition, we note the comment pointing out that our proposal would eliminate the existing requirement to disclose the role of compensation consultants retained by management rather than the compensation committee. Consequently, we have concluded that this change to the existing requirement is not appropriate. In lieu of our proposal to integrate the Section 10C(c)(2) disclosure requirements with the existing disclosure rule, we have determined to adopt a new disclosure provision, new Item 407(e)(3)(iv), to implement Section 10C(c)(2).

Under Item 407(e)(3)(iii), registrants will continue to be required to disclose “any role of compensation consultants in determining or recommending the amount or form of executive and director compensation.” Specifically, registrants will continue to be required to:

- identify the consultants;

- state whether such consultants were engaged directly by the compensation committee or any other person;
- describe the nature and scope of the consultant’s assignment and the material elements of any instructions given to the consultants under the engagement; and
- disclose the aggregate fees paid to a consultant for advice or recommendations on the amount or form of executive and director compensation and the aggregate fees for additional services if the consultant provided both and the fees for the additional services exceeded \$120,000 during the fiscal year.²³⁵

With respect to the new requirement in Item 407(e)(3)(iv) to disclose compensation consultant conflicts of interest, we have decided to use the “any role” disclosure trigger rather than the “obtained or retained the advice” trigger included in Section 10C. Hence, the new requirement will apply to any compensation consultant whose work must be disclosed pursuant to Item 407(e)(3)(iii), regardless of whether the compensation consultant was retained by management or the compensation committee or any other board committee. We believe that this approach is consistent with the meaning of the words “retained or obtained” (emphasis added) in Section 10C, as there will be little practical difference in the application of the two disclosure triggers as they relate to consultants advising on executive compensation matters. Based on the comments on this aspect of the proposal, we also believe that the existing disclosure trigger is well-understood by issuers. Because we are not changing the disclosure trigger, we no longer find it necessary to include an instruction to clarify when a compensation committee has

²³⁵ The rule will continue not to require fee disclosure for compensation consultants that work with management if the compensation committee has retained a separate compensation consultant. As we noted in the Proxy Disclosure Enhancements Release, in this situation, the compensation committee may not be relying on the compensation consultant retained by management and potential conflicts of interest are therefore less of a concern.

“obtained” advice. We are persuaded by commentators who expressed the view that the instruction, as proposed, was overly broad.

As is the case with our existing requirement to disclose the role of compensation consultants in determining or recommending the amount or form of executive and director compensation, issuers will be required to comply with the new disclosure requirement relating to compensation consultant conflicts of interest in a proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected. Although Section 10C(c)(2) is not explicitly limited to proxy statements for meetings at which directors will be elected, we believe this approach is appropriate in light of the approach in our rules to disclosure of compensation consultant matters generally.

This new subparagraph will apply to issuers subject to our proxy rules, including controlled companies, non-listed issuers and smaller reporting companies.²³⁶ Although Section 10C(c)(2) does not mandate this disclosure for issuers that will not be subject to the listing standards required by Rule 10C-1, we believe that investors are better served by requiring all issuers subject to our proxy rules to provide timely disclosure of compensation consultants’ conflicts of interests, which will enable investors to adequately monitor compensation committee performance and will help investors make better informed voting decisions with respect to the election of directors, including members of the compensation committee. Under the final amendments, issuers subject to our proxy rules will be required to disclose, with respect to any compensation consultant that is identified pursuant to Item 407(e)(3)(iii) as having played a role in determining or recommending the amount or form of executive and director compensation,

²³⁶ Foreign private issuers that are not subject to our proxy rules will not be required to provide this disclosure. Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation consultant disclosure requirement in Item 407(e)(3) of Regulation S-K. See Item 7(g) of Schedule 14A. As we proposed, registered investment companies will continue to provide disclosure under Item 22 and will not be subject to the amendments to Item 407(e) adopted in this release.

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. As commentators generally supported our proposal to identify the independence factors that a compensation committee must consider before selecting a compensation adviser as among the factors that should be considered in determining whether a consultant conflict of interest exists, the final amendments will include an instruction to Item 407(e)(3) noting that, in deciding whether there is a conflict of interest that may need to be disclosed, issuers should, at a minimum, consider the six factors set forth in Rule 10C-1(b)(4)(i) through (vi).

We are sensitive to the additional burdens placed on issuers from the expansion of disclosure obligations under our rules. In light of those concerns, the final rule will not require disclosure of potential conflicts of interest or an appearance of a conflict of interest, nor will it require disclosure with respect to compensation advisers other than compensation consultants. These additional disclosures are not mandated by Section 10C, and we are not persuaded that the additional burdens of requiring this disclosure are justified by the potential benefit to investors.

b. Disclosure Exemptions

We proposed to eliminate the disclosure exemption in Item 407(e)(3) for compensation consulting services involving only broad-based, non-discriminatory plans and the provision of non-customized survey data. Several commentators opposed to the proposed elimination noted that, when the disclosure exemptions in Item 407(e)(3)(iii) were adopted in December 2009, we stated that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that would warrant disclosure of the consultant's selection, terms of engagement or fees.²³⁷ We continue to believe that compensation consulting work limited to these activities does not raise conflict of interest concerns. Accordingly, consulting on

²³⁷ See letters from ABA, Davis Polk and SCSGP.

broad-based plans and providing non-customized benchmark data will continue to be exempted from the compensation consultant disclosure requirements under Item 407(e)(3), including the new conflicts of interest disclosure required in our rules implementing Section 10C(c)(2).

c. Disclosure Regarding Director Compensation

Several commentators requested that we clarify that the proposed amendments to Item 407(e)(3)(iii) apply only to board committees that are charged with determining executive compensation and not to other committees that oversee the compensation of non-employee directors.²³⁸ We believe these comments were prompted by our proposal, described above, to replace the existing disclosure trigger in Item 407(e)(3)(iii) with our proposed trigger, which referenced compensation consultants retained by the compensation committee. As discussed above, we have determined to retain the existing disclosure trigger in Item 407(e)(3), which requires disclosure of the role played by compensation consultants in determining or recommending “executive and director compensation” (emphasis added).

Issuers are currently required to discuss in proxy and information statements the role played by compensation consultants in determining or recommending the amount or form of director compensation, including the nature and scope of their assignment and any material instructions or directions governing their performance under the engagement and to provide fee disclosure, all to the same extent that the disclosure is required regarding executive compensation. In light of the approach we are taking to the new disclosure requirement generally, which is to add the new requirement to the existing disclosure requirements using the existing triggers, we believe it is appropriate to apply the compensation consultant conflict of interest disclosure requirement to director compensation in the same manner as executive

²³⁸ See, e.g., letters from CEC, Chamber, Davis Polk, Pfizer and SCSGP.

compensation. We believe this will benefit investors by providing for more complete and consistent disclosures on how the board manages compensation-related conflicts of interest. Accordingly, to the extent consulting on director compensation raises a conflict of interest on the part of the compensation consultant, disclosure would be required in response to new Item 407(e)(3)(iv).

D. Transition and Timing

The Act did not establish a specific deadline by which the listing standards promulgated by the exchanges must be in effect. To facilitate timely implementation of the proposals, we proposed that each exchange must provide to the Commission, no later than 90 days after publication of our final rule in the Federal Register, proposed listing rules or rule amendments that comply with our final rule. Further, we proposed that each exchange would need to have final rule or rule amendments that comply with our final rule approved by the Commission no later than one year after publication of our final rule in the Federal Register.

Comments were mixed on these proposals. One commentator did not believe that the 90-day period would afford the exchanges enough time to draft the proposed rules or rule amendments or to work through related concerns or issues.²³⁹ The only comment letter we received from an exchange, however, indicated that the 90-day period would be adequate.²⁴⁰ The exchange recommended, however, that instead of obligating exchanges to have rules approved by the Commission within any set timeframe, we should instead require exchanges to respond to any written comments issued by the Commission or its staff within 90 days.

Two commentators requested that we clarify that the exchanges may provide their listed issuers a transition period to come into compliance with the listing standards required by Rule

²³⁹ See letter from Debevoise.

²⁴⁰ See letter from NYSE.

10C-1.²⁴¹ Two other commentators requested that the Commission include a transition period for newly listed issuers directly in Rule 10C-1.²⁴² One of these commentators also recommended a two-year delayed phase-in period for smaller reporting companies, if they are not exempted entirely from the compensation committee and independence requirements and consultant disclosures.²⁴³ Another commentator requested that we establish a specific time period by which all listed issuers must comply with an exchange's new or amended rules meeting the requirements of our final rules.²⁴⁴ This commentator believed that a longer time frame, such as a year, would give listed issuers sufficient time to comply with the new standards.

After consideration of the comments, we are adopting the implementation period as proposed. We believe that retaining the requirement for each exchange to have final rule or rule amendments that comply with our final rule approved by the Commission no later than one year after publication of our final rule in the Federal Register will ensure that the exchanges work expeditiously and in good faith to meet the requirements of the new rule. We also note that Rule 10A-3 included a similar requirement with a significantly shorter compliance period.²⁴⁵ Although the final rule does not provide an extended transition period for newly listed issuers, we note that the exemptive authority provided to the exchanges under the final rule permits them to propose appropriate transition periods. As noted above, we are exempting smaller reporting companies from the requirements of Rule 10C-1.

²⁴¹ See letters from NYSE and S&C.

²⁴² See letters from ABA and Davis Polk.

²⁴³ See letter from ABA.

²⁴⁴ See letter from Debevoise.

²⁴⁵ The release adopting Rule 10A-3 was published in the Federal Register on April 16, 2003. The exchanges were required to have final rules or rule amendments that complied with Rule 10A-3 approved by the Commission no later than December 1, 2003.

Section 10C(c)(2) provides that the compensation consultant conflict of interest disclosure would be required with respect to meetings occurring on or after the date that is one year after the enactment of Section 10C, which was July 21, 2011; however, the statute also requires these disclosures to be “in accordance with regulations of the Commission,” and, prior to the adoption of these new rules, our regulations have not required such disclosures to be made. We recognize that issuers will need to implement disclosure controls and procedures to collect and analyze information relevant to whether their compensation consultants have a conflict of interest. As a result, we have decided to require compliance with new Item 407(e)(3)(iv) in any proxy or information statement for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors will be elected occurring on or after January 1, 2013.

III. PAPERWORK REDUCTION ACT

A. Background

Certain provisions of the final rule and rule amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).²⁴⁶ We published a notice requesting comment on the collection of information requirements in the Proposing Release for the rule amendments, and we submitted these requirements to the Office of Management and Budget (“OMB”) for review in accordance with the PRA.²⁴⁷ The titles for the collection of information are:

- (1) “Regulation 14A and Schedule 14A” (OMB Control No. 3235-0059);
- (2) “Regulation 14C and Schedule 14C” (OMB Control No. 3235-0057); and

²⁴⁶ 44 U.S.C. 3501 *et seq.*

²⁴⁷ 44 U.S.C. 3507(d) and 5 CFR 1320.11.

(3) “Regulation S-K” (OMB Control No. 3235-0071).²⁴⁸

Regulation S-K was adopted under the Securities Act and Exchange Act; Regulations 14A and 14C and the related schedules were adopted under the Exchange Act. The regulations and schedules set forth the disclosure requirements for proxy and information statements filed by companies to help investors make informed investment and voting decisions. The hours and costs associated with preparing, filing and sending the schedules constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. Compliance with the new rule and rule amendments will be mandatory. Responses to the information collections will not be kept confidential, and there is no mandatory retention period for the information disclosed.

B. Summary of the Final Rules

As discussed in more detail above, we are adopting new Rule 10C-1 under the Exchange Act and amendments to Item 407(e)(3) of Regulation S-K. Rule 10C-1 will direct the exchanges to prohibit the listing of any equity security of an issuer, subject to certain exceptions, that is not in compliance with several enumerated standards relating to the issuer’s compensation committee and the process for selecting a compensation adviser to the compensation committee. Rule 10C-1 will not impose any collection of information requirements on the exchanges or on listed issuers.

The amendments to Item 407(e)(3) will require issuers, other than registered investment companies,²⁴⁹ to disclose, in any proxy or information statement relating to an annual meeting of

²⁴⁸ The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosure requirements in Regulation S-K and is reflected in the analysis of these forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burden imposed by Regulation S-K to be a total of one hour.

shareholders (or a special meeting in lieu of an annual meeting) at which directors are to be elected, whether the work of any compensation consultant that has played any role in determining or recommending the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant 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) has raised a conflict of interest. If so, the issuer must also disclose the nature of the conflict and how the conflict is being addressed.

C. Summary of Comment Letters and Revisions to Proposals

In the Proposing Release, we requested comment on our PRA burden hour and cost estimates and the analysis used to derive such estimates. Only one commentator specifically addressed our PRA analysis and burden estimates of the proposed amendments.²⁵⁰ This commentator asserted that some of the estimates we used to calculate the burden hours of the proposed amendments may be inaccurate, which could result in our underestimating the actual burden of the amendments. This commentator, however, did not provide any alternative burden hour or cost estimates for us to consider and did not identify any particular estimates included in the Proposing Release that it believed to be inaccurate.

In response to comments on the proposals, we have made modifications to the rule proposals that will reduce the compliance burden on issuers. First, the final rule amendments

²⁴⁹ Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation consultant disclosure requirement in Item 407(e)(3) of Regulation S-K. See Item 7(g) of Schedule 14A. As we proposed, registered investment companies will continue to provide disclosure under Item 22 and will not be subject to the amendments to Item 407(e) adopted in this release.

²⁵⁰ See letter from Chamber.

leave intact the existing exemption from the requirement to disclose the role of a compensation consultant where that role is limited to providing advice on broad-based plans and information that either is not customized for a particular issuer or is customized based on parameters that are not developed by the consultant and about which the consultant does not provide advice.

Accordingly, issuers will be required to provide less disclosure than would have been required under the proposed amendments. Second, we have retained the existing disclosure trigger in Item 407(e)(3) and eliminated the proposed instruction regarding whether a compensation committee has “obtained the advice” of a compensation consultant. Based on comments received that issuers are already familiar with and have adopted business practices to comply with the existing disclosure trigger, we believe retaining the existing disclosure trigger will make it easier for issuers to determine whether conflict of interest disclosure is required for a particular compensation consultant.

D. Revisions to PRA Reporting and Cost Burden Estimates

As a result of the changes described above, we have reduced our reporting and cost burden estimates for the collection of information under the final amendments. The final rule amendments to Item 407(e)(3) of Regulation S-K will require additional disclosure in proxy or information statements filed on Schedule 14A or Schedule 14C of whether the work of a compensation consultant that has played any role in determining or recommending the amount or form of executive and director compensation, with certain exceptions, has raised a conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed. The instruction to Item 407(e)(3)(iv) provides that an issuer, in determining whether there is any such conflict, should consider the same six independence factors that the compensation committee of a listed issuer is required to consider before selecting a compensation adviser. For purposes of

the PRA, we now estimate that the total annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed amendments will be approximately 11,970 hours of in-house personnel time and approximately \$1,596,000 for the services of outside professionals.²⁵¹ We estimate that the amendments to Item 407(e)(3) of Regulation S-K would impose on average a total of two incremental burden hours per issuer. These estimates include the time and the cost of collecting the required information, preparing and reviewing responsive disclosure, and retaining records. We continue to believe it is appropriate to assume that the burden hours associated with the amendments will be comparable to the burden hours related to similar disclosure requirements under our current rules regarding compensation consultants. Our estimates, as well as their reasonableness, were presented to the public for consideration, and we received no alternative burden hour or cost estimates in response.²⁵²

The table below shows the total annual compliance burden, in hours and in costs, of the collection of information pursuant to the final amendments to Item 407(e)(3) of Regulation S-K.²⁵³ The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take an issuer to prepare and review the adopted disclosure requirements. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. For purposes of the PRA, we estimate that 75% of the burden of preparation of Schedules 14A and 14C is carried by the issuer internally and that 25% of the burden of preparation is carried by

²⁵¹ Our estimates represent the average burden for all issuers, both large and small.

²⁵² See Proxy Disclosure Enhancements Release (in which the Commission estimated the average incremental disclosure burden for the rule amendments to Item 407(e)(3) relating to compensation consultants to be three hours).

²⁵³ For convenience, the estimated hour and cost burdens in the table have been rounded to the nearest whole number.

outside professionals retained by the issuer at an average cost of \$400 per hour. There is no change to the estimated burden of the collections of information under Regulation S-K because the burdens that this regulation imposes are reflected in our burden estimates for Schedules 14A and 14C.

Table 1. Estimated incremental paperwork burden under the final rules for Schedules 14A and 14C.

	Number of responses (A) ²⁵⁴	Incremental burden hours/form (B)	Total incremental burden hours (C)=(A)*(B)	Internal company time (D)	External professional time (E)	Professional costs (F)=(E)*\$400
Sch. 14A	7,300	2	14,600	10,950	3,650	\$1,460,000
Sch. 14C	680	2	1,360	1,020	340	\$ 136,000
Total	7,980		15,960	11,970	3,990	\$1,596,000

IV. ECONOMIC ANALYSIS

A. Background and Summary of the Rule Amendments

As discussed above, we are adopting a new rule and rule amendments to implement Section 10C of the Exchange Act, as added by Section 952 of the Act. Section 10C of the Exchange Act requires us to adopt rules directing the exchanges to prohibit the listing of any equity security of an issuer, with certain exceptions, that is not in compliance with several enumerated standards regarding compensation committees. In addition, Section 10C(c)(2) requires each listed 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

²⁵⁴ The information in this column is based on the number of responses for these schedules as reported in the OMB's Inventory of Currently Approved Information Collections, available at <http://www.reginfo.gov/public/do/PRAMain.jsessionid=D37174B5F6F9148DB767D63DF6983A65>.

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. The rule and rule amendments we are adopting implement these mandates, and also include the following provisions:

- New Rule 10C-1 will direct the exchanges to adopt listing standards that apply to any board committee that oversees executive compensation, whether or not such committee performs other functions or is formally designated as a “compensation committee.”
- The exchanges will be directed to apply the required listing standards, other than those relating to the authority to retain compensation advisers in Rule 10C-1(b)(2)(i) and required funding for payment of such advisers in Rule 10C-1(b)(3), also to those members of a listed issuer’s board of directors who, in the absence of a board committee performing such functions, oversee executive compensation matters on behalf of the board of directors.
- With respect to the factors required by Section 10C(b) of the Exchange Act, we are adopting one additional independence factor that compensation committees must consider before engaging a compensation adviser.
- An instruction to final Rule 10C-1(b)(4) will provide that the compensation committee of a listed issuer is not required to consider the independence factors before consulting with or receiving advice from in-house counsel.
- We are exempting security futures products, standardized options, and smaller reporting companies from the scope of Rule 10C-1.

- For purposes of Rule 10C-1, we are modifying the definition of a controlled company, which is exempt from Rule 10C-1, to be a listed company in which more than 50% of the voting power for the election of directors is held by an individual, a group or another company, which is consistent with the definition used by the NYSE and Nasdaq.
- The final rules will require the disclosures relating to compensation consultant conflicts of interest called for by Section 10C(c)(2) only in proxy or information statements for meetings at which directors are to be elected.
- The compensation consultant conflicts of interest disclosure requirement will apply when a compensation consultant plays “any role” in “determining or recommending the amount or form of executive and director compensation,” other than any role limited to consulting on broad-based plans or providing non-customized benchmark data, which is consistent with the existing Item 407(e)(3)(iii) of Regulation S-K standard.
- The compensation consultant conflicts of interest disclosure requirement will apply to all issuers subject to our proxy rules, including controlled companies, smaller reporting companies and non-listed issuers.
- The compensation consultant conflicts of interest disclosure requirement will require disclosure of compensation consultant conflicts of interest that relate to director compensation, in addition to executive compensation.
- The instruction to the compensation consultant conflicts of interest disclosure requirement provides that an issuer, in determining whether there is a conflict of interest, should consider the same six independence factors that the compensation

committee of a listed issuer is required to consider before selecting a compensation adviser.

We are sensitive to the costs and benefits imposed by our rules. The discussion below attempts to address both the costs and benefits of Section 10C, as well as the incremental costs and benefits of the rule and rule amendments we are adopting within our discretion to implement Section 10C. These two types of costs and benefits may not be entirely separable to the extent our discretion is exercised to realize the benefits that we believe were intended by Section 952 of the Act. Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition.²⁵⁵ In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 2(b) of the Securities Act²⁵⁶ and Section 3(f) of the Exchange Act²⁵⁷ require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. We have integrated our consideration of those issues into this economic analysis.

In the Proposing Release, we solicited comment on the costs and benefits of the proposed rules, whether the proposed rule and rule amendments would place a burden on competition, and the effect of the proposal on efficiency, competition, and capital formation. Only one commentator specifically addressed the cost-benefit analysis we included in the Proposing Release or our analysis of whether the proposals would burden competition or impact efficiency,

²⁵⁵ 15 U.S.C. 78w(a)(2).

²⁵⁶ 15 U.S.C. 77b(b).

²⁵⁷ 15 U.S.C. 78c(f).

competition, and capital formation.²⁵⁸ This commentator argued that the proposals would impose additional compensation disclosure and director independence requirements that could be burdensome and result in additional disclosure of an issuer’s use of compensation consultants, without in every case providing meaningful benefit to issuers or investors, and that could also confuse investors or deter investors from “reading proxy materials by increasing their length and density without pruning other, less pertinent, or dated disclosures.”²⁵⁹ As discussed throughout this release, we have made numerous revisions to the proposed rules in order to address these concerns and reduce compliance burdens where consistent with investor protection. Other commentators addressed specific aspects of the proposed rule amendments that identified possible costs, benefits, or effects on efficiency, competition or capital formation, which we discuss in more detail below.

B. Benefits and Costs, and Impact on Efficiency, Competition and Capital Formation

1. Section 10C of the Exchange Act, as added by Section 952 of the Act

New Rule 10C-1 implements the listing standard requirements of Section 10C by directing the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with the following standards:

- Each member of the compensation committee of the issuer must be a member of the issuer’s board of directors and independent according to independence criteria determined by each exchange following consideration of specified factors;
- The compensation committee of each issuer must be directly responsible for the appointment, compensation, retention and oversight of the work of any compensation

²⁵⁸ See letter from Chamber.

²⁵⁹ Id.

- adviser retained by the committee, and each such compensation adviser must report directly to the compensation committee;
- Each compensation committee must have the authority to retain independent legal counsel and other compensation advisers;
 - The compensation committee of each issuer may select a compensation adviser only after assessing the adviser's independence using specified factors; and
 - Each issuer must provide appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to compensation advisers retained by the compensation committee.

Under the final rule, subject to our review in accordance with Section 19(b) of the Exchange Act, an exchange may exempt any category of issuers from the compensation committee listing requirements and any particular relationships from the compensation committee member independence requirements, as the exchange determines is appropriate, after consideration of the impact of the requirements on smaller reporting issuers and other relevant factors.

The rules we are adopting are intended to benefit both issuers and investors. The final rules are expected to help achieve Congress's intent that listed issuers' board committees that set compensation policy consist only of directors who are independent. By requiring compensation committees to consider the independence of potential compensation advisers before they are selected, the final rules should also help assure that compensation committees of affected listed issuers are better informed about potential conflicts, which could reduce the likelihood that they are unknowingly influenced by conflicted compensation advisers. The provisions of the listing standards that will require compensation committees to be given the authority to engage, oversee and compensate independent compensation advisers should bolster the access of board

committees of affected listed issuers that are charged with oversight of executive compensation to the resources they need to make better informed compensation decisions. Taken as a whole, these requirements could benefit issuers and investors to the extent they enable compensation committees to make better informed decisions regarding the amount or form of executive compensation.

The listing standard provisions of the rule and rule amendments will also result in certain costs to exchanges and affected listed issuers. Final Rule 10C-1 directs the exchanges 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. Exchanges will incur direct costs to comply with the rule, as they will need to review their existing rules and propose appropriate rule changes to implement the requirements of Rule 10C-1. Once the exchanges have adopted listing standards required by Rule 10C-1, listed issuers will incur costs in assessing and demonstrating their compliance with the new listing standards. We note that these costs are primarily imposed by statute.

The adoption of new listing standards may have some distributional effects as some listed issuers may seek to list on foreign exchanges or other markets to avoid compliance with listing requirements that an exchange develops. To the extent they do so, listed issuers would incur costs in seeking to transfer their listings, and exchanges that lose issuer listings would, as a result, lose related fees and trading volume. We believe that any such effect would be minimal as the exchanges already require directors on compensation committees or directors determining

or recommending executive compensation matters for domestic issuers to be “independent” under their general independence standards.²⁶⁰

As required by Section 10C, Rule 10C-1 directs the exchanges to develop a definition of independence applicable to compensation committee members after considering the relevant factors set forth in Exchange Act Section 10C(a)(3). These factors include:

- a director’s source of compensation, including any consulting, advisory or compensatory fee paid by the issuer; and
- whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

We are not adopting any additional factors that the exchanges must consider in determining independence requirements for compensation committee members. Instead, Rule 10C-1 affords the exchanges latitude in determining the required independence standards. Several commentators indicated that the proposed rule would permit the exchanges to determine listing standards that take into account the characteristics of each exchange’s listed issuers.²⁶¹ We believe that affording the exchanges flexibility in determining the required independence standards, subject to our review pursuant to Section 19(b) of the Exchange Act, will result in more efficient and effective determinations as to the types of relationships that should preclude a finding of independence with respect to membership on a board committee that oversees executive compensation. We believe that because listed issuers frequently consult the exchanges regarding independence determinations, the exchanges will be in the best position to identify the

²⁶⁰ See, e.g., NYSE Listed Company Manual Section 303A.05(a) and Nasdaq Rule 5605(d). Foreign private issuers are permitted under these listing standards to follow home country practice with respect to executive compensation oversight.

²⁶¹ See letters from ABA and NYSE.

types of relationships that are likely to compromise the ability of an issuer's compensation committee to make impartial determinations on executive compensation.

We acknowledge, however, that because exchanges compete for listings, they may have an incentive to propose standards that issuers will find less onerous. This could affect investor confidence in the degree of independent oversight of executive compensation at issuers listed on exchanges with less onerous standards and could also result in costs to exchanges that adopt relatively more rigorous standards, to the extent they lose issuer listings as a result.

In accordance with Section 10C(a)(1), Rule 10C-1(b)(1)(iii) exempts limited partnerships, companies in bankruptcy proceedings, registered open-end management investment companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee from the compensation committee member independence listing standards required under Rule 10C-1(a). With respect to the independence requirements of Rule 10C-1, we have not provided any exemptions for categories of issuers beyond those specified in Section 10C(a)(1). The final rule, however, exempts smaller reporting companies, controlled companies, security futures products and standardized options from all of the requirements of Rule 10C-1, including the independence requirements. Under Rule 10C-1, exchanges are provided the authority to propose additional exemptions for appropriate categories of issuers. An exchange that exercises this authority will incur costs to evaluate what exemptions to propose and to make any required rule filings pursuant to Section 19(b) of the Exchange Act.

We are implementing the disclosure requirements of Section 10C by adopting amendments to Item 407(e)(3) of Regulation S-K. Given the number of discretionary choices

that we have made in implementing this provision of Section 10C, we discuss the amendments to Item 407 as a whole below.

2. Discretionary Amendments

As adopted, new Rule 10C-1 will direct the exchanges to adopt listing standards that apply to any committee of the board that oversees executive compensation, whether or not such committee performs other functions or is formally designated as a “compensation committee.” Some exchange listing standards currently require issuers to form compensation or equivalent committees, and others permit independent directors to oversee specified compensation matters in lieu of the formation of a compensation or equivalent committee. The final rule will also direct the exchanges to apply the required listing standards relating to director independence, consideration of a compensation adviser’s independence and responsibility for the appointment, compensation and oversight of compensation advisers to those members of a listed issuer’s board of directors who, in the absence of a board committee performing such functions, oversee executive compensation matters on behalf of the board of directors.²⁶² Several commentators supported our proposal to apply the Section 10C requirements to all board committees that oversee executive compensation, and also recommended that the requirements also apply to those independent directors who oversee executive compensation in lieu of a board committee.²⁶³ We believe these aspects of the rule will help achieve the objectives of the statute and benefit listed issuers by providing clarity and reducing any uncertainty about the application of Section

²⁶² With respect to these aspects of the rule, we have defined “compensation committee” to include those board members who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. In our discussion of the final rule throughout this release, references to an issuer’s “compensation committee” include, unless the context otherwise requires, any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not formally designated as a “compensation committee,” as well as, to the extent applicable, those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of such a committee.

²⁶³ See, e.g., letters from Barnard, CFA and Railpen.

10C. Moreover, this should benefit investors because it will limit the ability of listed issuers to avoid the compensation committee independence requirements under Section 10C simply by delegating oversight of executive compensation to a board committee that is not formally designated as the “compensation committee,” but performs that function or to directors acting outside of a formal committee structure.

If we did not apply Rule 10C-1 to apply the requirements relating to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to directors who oversee executive compensation matters in the absence of a board committee, issuers could be incentivized to seek to list on exchanges that do not require the formation of a compensation or equivalent committee in order to avoid having to comply with the compensation committee independence standards that would otherwise apply. Our decision to apply the requirements relating to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to these directors should minimize any such incentive. As a result, we believe this application also minimizes any potential costs that issuers might incur to alter their existing committee structure or seek to list on a different exchange to avoid having to comply with the new standards, as well as any related costs that exchanges would incur from any resulting loss of issuer listings, related fees, and trading volume. These impacts may not be significant, however, since the exchanges’ existing requirements already impose independence requirements on directors who oversee executive compensation matters. Finally, we note that, in overseeing executive compensation matters, these independent directors are acting as the board of directors, and the same board processes that attend to other types of board decisions – e.g., scheduling meetings, preparing

review materials, attending meetings, preparing and reviewing meeting minutes – also presumably attend to board decisions about executive compensation. Accordingly, we do not believe that the application of the requirements relating to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to directors who oversee executive compensation matters in the absence of a board committee will result in any disproportionate incremental burdens for issuers that do not have a compensation committee or any other board committee that oversees executive compensation.

As required by Section 10C(g), controlled companies are exempt from all requirements of Rule 10C-1 pursuant to final Rule 10C-1(b)(5)(ii). Rule 10C-1 as adopted includes a slightly broader definition of “controlled company” than the definition provided in Section 10C. Under Section 10C(g)(2) of the Exchange Act, a “controlled company” is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. We proposed to incorporate this definition into Rule 10C-1(c)(2). In response to comments that our proposed definition would not exempt listed issuers that would otherwise be controlled companies but for the fact that they do not hold director elections,²⁶⁴ we have removed from the definition the phrase “holds an election for the board of directors” in order to align the definition in Rule 10C-1 more closely to the definition of controlled company currently used by the NYSE and Nasdaq. This change will eliminate any unnecessary compliance burdens for listed issuers that do not hold director elections but satisfy the definition of “controlled company” pursuant to listing standards of the NYSE, Nasdaq and other exchanges with a similar definition.

²⁶⁴ See letter from V&E.

Under Rule 10C-1(b)(4), the exchanges are directed to adopt listing standards that require a compensation committee to take into account the five independence factors enumerated in Section 10C(b)(2) before selecting a compensation adviser. In addition to these five factors, we are including in the final rule one additional independence factor that must be considered before a compensation adviser is selected: any business or personal relationships between the executive officers of the issuer and the compensation adviser or the person employing the adviser. Several commentators supported requiring compensation committees to consider any business or personal relationship between an executive officer of the issuer and an adviser or the person employing the compensation adviser.²⁶⁵ This would include, for example, situations where the chief executive officer of a listed issuer and the compensation adviser have a familial relationship or where the chief executive officer and the compensation adviser (or the adviser's employer) are business partners. We agree with commentators that such relationships would be relevant to an assessment of the independence of the compensation adviser and believe that adding this factor complements the five independence factors enumerated in Section 10C(b)(2). Adding this factor should help compensation committees reach better informed decisions in selecting compensation advisers since any business or personal relationship that a compensation adviser, or the person employing the adviser, may have with an executive officer may be relevant to assessing whether there is a conflict of interest. Section 10C(b) mandates that the independence factors to be considered must be competitively neutral among categories of compensation advisers and that compensation committees must be able to retain the services of members of any such category. We believe that the six factors included in the final rule, when

²⁶⁵ See, e.g., letters from ABA, Better Markets, Merkl and USS.

considered as a whole, are competitively neutral and that this requirement will therefore not inhibit competition among categories of compensation advisers.

We have included an instruction to Rule 10C-1(b)(4) that provides that the compensation committee of a listed issuer is not required to consider the independence factors with respect to in-house counsel with whom the compensation committee consults or obtains advice. Several commentators noted that, as in-house legal counsel are employees of the issuer, they are not held out to be independent.²⁶⁶ As such, the benefits of requiring the compensation committee to consider the independence factors with respect to in-house counsel would seem to be minimal. We do not believe that our determination to exclude in-house counsel from this required consideration will negatively impact competition among compensation advisers, as we do not believe compensation committees consider that in-house counsel serve in the same role as a compensation consultant or outside legal counsel.

As adopted, the final rule exempts security futures products and standardized options from the scope of Rule 10C-1. We believe that exempting security futures products and standardized options is appropriate because these securities are fundamentally different than the equity securities of an operating company. This exemption will benefit the issuers of these securities and the exchanges on which such securities trade by providing clarity and eliminating any regulatory uncertainty about the application of Section 10C to these products.

In addition, we are exempting smaller reporting companies from the requirements of Rule 10C-1. We appreciate that the burdens of complying with the listing standards mandated by Rule 10C-1 for listed smaller reporting companies may not be significant given that such issuers are already subject to listing standards requiring directors on compensation committees or

²⁶⁶ See letters from Davis Polk and S&C.

directors determining or recommending executive compensation matters to be “independent” under the exchanges’ general independence standards. We do believe, however, that exempting smaller reporting companies from the listing standards mandated by Rule 10C-1 can offer cost savings to these issuers to the extent that an exchange, in connection with the listing standards review required by Rule 10C-1, chooses to create a new independence standard for compensation committee members that is more rigorous than its existing standards – for example, a new standard could address personal or business relationships between members of the compensation committee and the listed issuer’s executive officers. Issuers subject to the exchange’s new standard may need to replace existing compensation committee members, and incur the associated costs, if they do not qualify as independent under the new standard. In addition, although listed smaller reporting companies do not often engage outside compensation consultants, there would be cost savings to these listed issuers from not having to comply with the listing standards involving the compensation committee’s engagement and oversight of compensation advisers. For example, the exchanges are required to adopt listing standards that require the compensation committee to consider the six independence factors listed in Rule 10C-1(b)(4) before selecting a compensation adviser. To comply with these listing standards, compensation committees will likely need to create procedures for collecting and analyzing information about potential compensation advisers before they can receive advice from such advisers, which would require the listed issuers to incur costs. We expect, however, that a portion of these cost savings would likely be offset by the costs that smaller reporting companies may incur in order to comply with the new disclosure requirements in Item 407(e)(3)(iv) of Regulation S-K relating to compensation consultants’ conflicts of interest.

We are adopting amendments to Item 407(e)(3) of Regulation S-K to implement the disclosure requirements of Section 10C(c)(2). Under these amendments, issuers subject to our proxy rules will be required to disclose whether the work of any compensation consultant that has played any role in determining or recommending the form or amount of executive and director compensation has raised a conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed. Issuers subject to our existing proxy disclosure rules must already discuss the role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, including the nature and scope of their assignment and any material instructions or directions governing their performance under the engagement. The current item excludes from the disclosure requirement any role of compensation consultants limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice. We believe the amendments complement our existing disclosure requirements by increasing the transparency of issuers' policies regarding compensation consultant conflicts of interest for all issuers subject to the existing disclosure requirement.

The final amendments preserve the existing disclosure requirements under Item 407(e)(3), including the disclosure trigger in Item 407(e)(3)(iii) of "any role" played by the consultant and the disclosure exemption for compensation consulting services involving only broad-based, non-discriminatory plans and the provision of non-customized survey data. Some

commentators suggested that retaining the existing disclosure trigger in Item 407(e)(3)(iii) and including a separate disclosure item within Item 407 to address the conflict of interest disclosure requirements of Section 10C(c)(2)(B) would be the better approach to implement Section 10C(c)(2) requirements.²⁶⁷ Additionally, commentators contended that eliminating the disclosure exemptions in Item 407(e)(3)(iii) would be inconsistent with our past determination that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that warrant disclosure of the consultant’s selection, terms of engagement or fees.²⁶⁸ We agree with these commentators and believe that the amendment to Item 407(e)(3) that we are adopting, which retains the existing disclosure exemptions, is the better approach to implementing Section 10C(c)(2)’s requirements. By retaining the existing disclosure trigger and disclosure exemptions under Item 407(e)(3)(iii), the final amendments will require disclosure of conflicts of interest only when a compensation consultant’s role is otherwise required to be disclosed. We believe this will promote efficiency by mitigating an issuer’s compliance burden in situations where a compensation consultant does not provide “analytical input, discretionary judgment or advice.”²⁶⁹

To promote comprehensive disclosure about compensation consultants, the amendments to Item 407(e)(3) extend the disclosure requirements of Section 10C(c)(2) to proxy and information statements where action is to be taken with respect to an election of directors, as well as to conflicts of interests for compensation consultants who play any role in determining or recommending the amount or form of director compensation. Existing Item 407(e)(3) already requires these proxy and information statements to include disclosure about any role of

²⁶⁷ See, e.g., letter from ABA.

²⁶⁸ See letters from ABA, Chamber and SCSGP.

²⁶⁹ See letter from SCSGP.

compensation consultants in determining or recommending the amount or form of executive compensation and director compensation, including the nature and scope of their assignment, any material instructions or directions governing their performance under the engagement, and specified information with respect to fees paid to the compensation consultants.

Several commentators supported applying the new disclosure requirements to all Exchange Act issuers subject to our proxy rules.²⁷⁰ However, other commentators believed that this is not required by Section 10C and opposed extending the disclosure requirements to non-listed issuers.²⁷¹ We are expanding the statutory disclosure requirement to those categories of issuers that will not be subject to the listing standards adopted by the exchanges pursuant to Rule 10C-1, including non-listed issuers, smaller reporting companies and controlled companies, because we believe that timely disclosure of compensation consultants' conflicts of interests will enable investors in these categories of issuers to better monitor compensation committee performance and will help investors make better informed voting decisions with respect to the election of directors, including members of the compensation committee. In addition, this would promote consistent disclosure on these topics among reporting companies and should benefit investors by fostering comparability of disclosure of compensation practices across companies.

Non-listed issuers, smaller reporting companies and controlled companies may incur additional costs to develop more formalized selection processes than they otherwise would have absent such a disclosure requirement. For example, even though they will not be subject to the listing standard requiring compensation committees to consider independence factors before selecting a compensation adviser, in light of this disclosure requirement, at the time any compensation consultant is selected, compensation committees of non-listed issuers, smaller

²⁷⁰ See, e.g., letters from AON and Merkl.

²⁷¹ See letter from Debevoise.

reporting companies and controlled companies may devote time and resources to analyzing and assessing the independence of the compensation consultant and addressing and resolving any conflicts of interest.²⁷² Although the disclosure requirement does not prohibit a compensation committee from selecting a compensation consultant of its choosing, some committees may elect to engage new, alternative or additional compensation consultants after considering what disclosure might be required under our final rules. Such decisions could result in additional costs to issuers, including costs related to termination of existing services and search and engagement costs to retain new consultants. In addition, costs may increase if an issuer decides to engage multiple compensation consultants for services that had previously been provided by a single consultant. We believe these potential costs are likely to be limited because our existing disclosure rules already require disclosure of any role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, including the nature and scope of their assignment, any material instructions or directions governing their performance under the engagement, and specified information with respect to fees paid to the compensation consultants. To the extent the new requirement to disclose compensation consultant conflicts of interest results in an issuer significantly modifying its consultant selection processes, we believe it would also likely result in such issuer making better-informed choices regarding compensation consultant selection.

²⁷² For purposes of the PRA, we estimated that the total annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed amendments will be approximately 11,970 hours of in-house personnel time and approximately \$1,596,000 for the services of outside professionals. One commentator asserted that some of the estimates we used to calculate the burden hours of the proposed amendments may be inaccurate, which could result in our underestimating the PRA burden of the final amendments. See letter from Chamber. As described in the discussion of the PRA, we received no alternative paperwork burden hour or cost estimates in response to our estimate of the paperwork burden in the Proposing Release. We believe our reduced paperwork burden estimate is reasonable in light of the modifications we have made to the proposals to reduce the compliance burden on issuers.

To the extent that providing advice on director compensation raises a conflict of interest on the part of a compensation consultant, disclosure would be required in response to new Item 407(e)(3)(iv). Issuers are currently required to discuss in proxy and information statements the role played by compensation consultants in determining or recommending the amount or form of director compensation to the same extent that the disclosure is required regarding executive compensation. In light of the approach we are taking to the new disclosure requirement generally, which is to add the new requirement to the existing disclosure requirements using the existing triggers, we determined that the compensation consultant conflict of interest disclosure requirement should apply to director compensation in the same manner as executive compensation. We believe this will benefit investors by providing for more complete and consistent disclosures on how the board manages compensation-related conflicts of interest.

The amendments to Regulation S-K may promote efficiency and competitiveness of the U.S. capital markets by increasing the transparency of executive compensation decision-making processes. Increased transparency may improve the ability of investors to make better informed voting and investment decisions, which may encourage more efficient capital allocation and formation. Some commentators asserted that the increased disclosure should improve the ability of investors to monitor performance of directors responsible for overseeing compensation consultants, thus enabling them to make more informed voting and investment decisions.²⁷³

The amendments also may affect competition among compensation consultants. By requiring disclosure of the existence of compensation consultant conflicts of interest and how those conflicts of interest are addressed, the new disclosure requirement may lead compensation committees to engage in more thorough and deliberative analyses of adviser independence. This

²⁷³ See, e.g., letters from CalSTRS and FLSBA.

could result in the selection of compensation advisers that are more independent or impartial than might otherwise be chosen, which, in turn, could promote more effective executive compensation practices. The amendments may also incentivize compensation consultants to adopt policies that serve to minimize any conflicts of interest and for compensation committees to avoid hiring consultants perceived as having a conflict of interest.

V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Final Regulatory Flexibility Analysis (“FRFA”) has been prepared in accordance with the Regulatory Flexibility Act.²⁷⁴ This FRFA relates to new Exchange Act Rule 10C-1, which will require the exchanges to prohibit the listing of an equity security of an issuer that is not in compliance with several enumerated requirements relating to the issuer’s compensation committee, and to amendments to Item 407(e)(3) of Regulation S-K, which will require new disclosure from issuers regarding any conflict of interest raised by the work of a compensation consultant that has played a role in determining or recommending the form or amount of executive and director compensation.

A. Need for the Amendments

We are adopting the new rule and rule amendments to implement Section 10C of the Exchange Act. Exchange Act Rule 10C-1 directs the exchanges to prohibit the listing of the equity securities of any issuer that does not comply with Section 10C’s compensation committee and compensation adviser requirements. The amendments to Regulation S-K will require issuers to provide certain disclosures regarding their use of compensation consultants and how they address compensation consultant conflicts of interest.

B. Significant Issues Raised by Public Comments

²⁷⁴ 5 U.S.C. 603.

In the Proposing Release, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed rules, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed rule and amendments. We did not receive comments specifically addressing the IRFA. However, some commentators addressed aspects of the proposed rules that could potentially affect small entities. In particular, one commentator expressed concern that smaller issuers may experience difficulty in locating qualified candidates to serve on compensation committees who could meet the independence standards that will be developed by the exchanges.²⁷⁵ This commentator advocated that smaller companies should be exempted from all or parts of the amendments.

C. Small Entities Subject to the Final Rules

The final rules will affect some companies that are small entities. The Regulatory Flexibility Act defines “small entity” to mean “small business,” “small organization,” or “small governmental jurisdiction.”²⁷⁶ The Commission’s rules define “small business” and “small organization” for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Exchange Act Rule 0-10(e)²⁷⁷ provides that the term “small business” or “small organization,” when referring to an exchange, means any exchange that: (1) has been exempted from the reporting requirements of Exchange Act Rule 601;²⁷⁸ and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined under Exchange Act Rule 0-10. No exchanges are small entities

²⁷⁵ See letter from ABA.

²⁷⁶ 5 U.S.C. 601(6).

²⁷⁷ 17 CFR 240.0-10(e).

²⁷⁸ 17 CFR 242.601.

because none meet these criteria. Securities Act Rule 157²⁷⁹ and Exchange Act Rule 0-10(a)²⁸⁰ define a company, other than an investment company, to be a “small business” or “small organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year. The final rules will affect small entities that have a class of equity securities that are registered under Section 12 of the Exchange Act. We estimate that there are approximately 457 such registrants, other than registered investment companies, that may be considered small entities. An investment company, including a business development company, is considered to be a “small business” if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.²⁸¹ We believe that the amendments to Regulation S-K will affect some small entities that are business development companies that have a class of securities registered under Section 12 of the Exchange Act. We estimate that there are approximately 28 business development companies that may be considered small entities.

D. Reporting, Recordkeeping and Other Compliance Requirements

Under new Exchange Act Rule 10C-1, the exchanges will be directed to prohibit the listing of an equity security of an issuer that is not in compliance with Section 10C’s compensation committee and compensation adviser requirements. These requirements relate to:

- the independence of compensation committee members;
- the authority of the compensation committee to retain compensation advisers;

²⁷⁹ 17 CFR 230.157.

²⁸⁰ 17 CFR 240.0-10(a).

²⁸¹ 17 CFR 270.0-10(a).

- the compensation committee’s responsibility to assess factors that affect the independence of compensation advisers before their selection by the compensation committee; and
- the compensation committee’s responsibility for the appointment, compensation, and oversight of the work of compensation advisers retained by the compensation committee; and funding for consultants and other advisers retained by the compensation committee.

Rule 10C-1 will not impose any reporting or recordkeeping obligations on the exchanges, or any issuers with equity securities listed on an exchange. Furthermore, the rule does not require a listed issuer to establish or maintain a compensation committee. As discussed in more detail below, we have exempted smaller reporting companies from the requirements of Rule 10C-1. We do not believe the new rule will have a significant impact on small entities because the listing requirements will apply only to issuers that have equity securities listed on an exchange and that are not smaller reporting companies.²⁸² All of the exchanges generally impose a combination of quantitative requirements such as market capitalization, minimum revenue, and shareholder equity thresholds that an issuer must satisfy in order to be listed on the exchange. Consequently, the substantial majority of small entities are not listed on an exchange but are quoted on the OTC Bulletin Board or the OTC Markets Group.²⁸³ Rule 10C-1 will not apply to

²⁸² Based on data obtained from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were two exchange-listed small entities that would not qualify as a smaller reporting company.

²⁸³ Based on information retrieved from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were less than twelve issuers that had total assets of \$5 million or less listed on an exchange.

In 2011, the Commission approved a proposal from NASDAQ OMX BX to create a new listing market, the BX Venture Market, which allows issuers meeting minimal quantitative requirements – including those with fewer than \$5 million in assets – to list on that exchange. A BX Venture Market-listed company is required to meet qualitative requirements that are, in many respects, similar to those required for listing on Nasdaq or other exchanges, including a requirement to have independent directors make decisions regarding the compensation of executive officers. See

the OTC Bulletin Board or the OTC Markets Group, and therefore small entities whose securities are quoted on these interdealer quotation systems would not need to comply with any listing standards developed under the rule by the exchanges. Small entities that are listed on an exchange and that are not smaller reporting companies would generally need to comply with the standards adopted by the exchange pursuant to Rule 10C-1 if they wish to have their equity securities listed on the exchange. Small entities subject to these listing standards may need to spend additional time and incur additional costs to comply with these standards. Consistent with Section 10C(f)(3), the final rule will allow the exchanges flexibility to propose exemptions for small entities, subject to our review and approval under the Exchange Act Section 19(b) rule filing process.

The amendments to Item 407(e)(3) of Regulation S-K will impose some reporting and recordkeeping obligations on small entities. Under the amendments, an issuer will be required to disclose whether the work of any compensation consultant that has played a role in determining or recommending the amount or form of executive and director compensation has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. This disclosure requirement will apply equally to both large and small issuers. One commentator has noted that many small entities do not use the services of a compensation consultant,²⁸⁴ which should significantly minimize the impact of the reporting and recordkeeping requirements under the amendments on small entities.

E. Agency Action to Minimize Effect on Small Entities

Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Order Granting Approval of Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Thereto to Create a Listing Market on the Exchange, Release No. 34-64437 (May 6, 2011) [76 FR 27710]. We understand that this new market has not yet listed any issuers or become operational. Small entities eligible to list on this market that are not smaller reporting companies would be subject to the listing standards required by Rule 10C-1.

²⁸⁴ See letter from ABA.

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

In connection with Exchange Act Rule 10C-1, we considered, but did not establish, different compliance requirements, or an exemption, for small entities. As noted above, very few small entities list their securities on an exchange. The substantial majority of small entities with publicly held equity securities are quoted on the OTC Bulletin Board and the OTC Markets Group. As these interdealer quotation systems are not affected by Rule 10C-1, the substantial majority of small entities will not be affected by the requirements under the rule.

In addition, we are providing an exemption from the requirements in Rule 10C-1 for smaller reporting companies. We estimate that as of December 31, 2010, the most recent data available, most of the small entities that were listed on an exchange would qualify as a smaller reporting company.²⁸⁵ Smaller reporting companies that are listed on an exchange are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under the

²⁸⁵ Based on data obtained from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were two exchange-listed small entities that would not qualify as a smaller reporting company.

exchanges' general independence standards. Accordingly, we do not believe that the additional burdens of complying with Rule 10C-1 are warranted for smaller reporting companies.

In addition, under Rule 10C-1, the exchanges will be expressly authorized to exempt particular categories of issuers from the requirements of Section 10C and particular relationships from the compensation committee membership requirements of Section 10C(a), taking into account the potential impact of the requirements on smaller reporting issuers. Because of the close relationship and frequent interaction between the exchanges and their listed issuers, we believe the exchanges will be in the best position to determine additional types of issuers, including any small entities that are not smaller reporting companies, that should be exempted from the listing requirements under the rule.

In connection with the amendments to Regulation S-K, we considered alternatives, including establishing different compliance or reporting requirements that take into account the resources available to small entities, clarifying or simplifying compliance and reporting requirements under the amendments for small entities, using performance rather than design standards, and exempting small entities from all or part of the amendments. We considered, but did not establish, different compliance requirements, or an exemption, for small entities. Although we believe it is appropriate to exempt smaller reporting companies from Rule 10C-1 because we do not believe that the additional burdens of complying with Rule 10C-1 are warranted for smaller reporting companies, we are unable to reach the same conclusion with respect to the disclosure requirements of amended Item 407(e)(3).

In our view, mandating uniform and comparable disclosures for all issuers subject to our proxy rules is consistent with the statute and will promote investor protection. We believe that investors have an interest in, and would benefit from disclosure regarding, conflicts of interest

involving compensation consultants, to the extent that they are used by small entities. Several commentators opposed providing an exemption to small issuers and noted that the required disclosure would provide investors with additional information that would allow them to make better informed investment and voting decisions.²⁸⁶ Different compliance requirements or an exemption from the amendments to Regulation S-K for small entities would interfere with achieving the goal of enhancing the information provided to all investors.

The amendments to Regulation S-K clarify, consolidate and simplify the compliance and reporting requirements for all entities, including small entities. Under the amendments, disclosure will only be required if a compensation consultant plays a role in determining or recommending the form or amount of executive and director compensation and the compensation consultant's work raises a conflict of interest. Although we believe the disclosure requirements are clear and straightforward, we have attempted to further clarify, consolidate and simplify the compliance and reporting requirements, by including an instruction to the amendments to provide guidance to issuers as to when a conflict of interest may be present that would require disclosure.

Final Rule 10C-1 uses a mix of performance and design standards. We are not specifying the procedures or arrangements an issuer or compensation committee must develop to comply with the listing standards required by Rule 10C-1, but compensation committees will be required to consider the factors specified in Rule 10C-1(b)(4) when conducting the required independence assessments. The amendments to Regulation S-K employ design standards rather than performance standards, as Section 10C(c)(2) mandates the specific disclosures that must be provided. Moreover, based on our past experience, we believe specific disclosure requirements

²⁸⁶ See, e.g., letters from CalPERS, FLSBA and RailPen.

will promote consistent and comparable disclosure among all companies, and the amendments are intended to result in more comprehensive and clear disclosure.

VI. STATUTORY AUTHORITY AND TEXT OF THE AMENDMENTS

The amendments contained in this release are being adopted under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act and Sections 3(b), 10C, 12, 14, 23(a) and 36 of the Exchange Act.

List of Subjects in 17 CFR Parts 229 and 240

Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENTS

For the reasons set out in the preamble, the Commission amends title 17, chapter II, of the Code of Federal Regulations as follows:

PART 229 - STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 - REGULATION S-K

1. The general authority citation for part 229 is revised and the sectional authorities are removed to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

2. Section 229.407 is amended by adding paragraph (e)(3)(iv) and an instruction to paragraph (e)(3)(iv) to read as follows:

§ 229.407 (Item 407) Corporate governance.

* * * * *

(e) * * *

(3) * * *

(iv) With regard to any compensation consultant identified in response to Item 407(e)(3)(iii) whose work has raised any conflict of interest, disclose the nature of the conflict and how the conflict is being addressed.

Instruction to Item 407(e)(3)(iv).

For purposes of this paragraph (e)(3)(iv), the factors listed in §240.10C-1(b)(4)(i) through (vi) of this chapter are among the factors that should be considered in determining whether a conflict of interest exists.

* * * * *

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for Part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78j-3, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

4. Add an undesignated center heading following § 240.10A-3 to read as follows:

Requirements Under Section 10C

5. Add § 240.10C-1 immediately following the new undesignated center heading to read as follows:

§240.10C-1 Listing standards relating to compensation committees.

(a) Pursuant to section 10C(a) of the Act (15 U.S.C. 78j-3(a)) and section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. 111-203, 124 Stat. 1900):

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

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

(3) Opportunity to cure defects. The rules required by paragraphs (a)(1) and (a)(2) of this section must provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for a prohibition under paragraph (a) of this section, before the imposition of such prohibition. Such rules may provide that if a member of a compensation committee ceases to be independent in accordance with the requirements of this section for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain a compensation committee member of the listed issuer until the earlier of the next annual

shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

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

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

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

(1) Independence. (i) Each member of the compensation committee must be a member of the board of directors of the listed issuer, and must otherwise be independent.

(ii) Independence requirements. In determining independence requirements for members of compensation committees, the national securities exchanges and national securities associations shall consider relevant factors, including, but not limited to:

(A) 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 member of the board of directors; and

(B) Whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

(iii) Exemptions from the independence requirements. (A) The listing of equity securities of the following categories of listed issuers is not subject to the requirements of paragraph (b)(1) of this section:

(1) Limited partnerships;

(2) Companies in bankruptcy proceedings;

(3) Open-end management investment companies registered under the Investment Company Act of 1940; and

(4) Any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.

(B) In addition to the issuer exemptions set forth in paragraph (b)(1)(iii)(A) of this section, a national securities exchange or a national securities association, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, may exempt from the requirements of paragraph (b)(1) of this section a particular relationship with respect to members of the compensation committee, as each national securities exchange or national securities association determines is appropriate, taking into consideration the size of an issuer and any other relevant factors.

(2) Authority to retain compensation consultants, independent legal counsel and other compensation advisers. (i) The compensation committee of a listed issuer, in its capacity as a

committee of the board of directors, may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser.

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

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

(A) To require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel or other adviser to the compensation committee; or

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

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

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

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

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

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

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

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

(vi) Any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the issuer.

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

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

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

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

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

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

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

(2) The term compensation committee means:

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

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

(iii) For purposes of this section other than paragraphs (b)(2)(i) and (b)(3), in the absence of a committee as described in paragraphs (c)(2)(i) or (ii) of this section, the members of the board of directors who oversee executive compensation matters on behalf of the board of directors.

(3) The term controlled company means an issuer:

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

June 20, 2012

[FR Doc. 2012-15408 Filed 06/26/2012 at 8:45 am; Publication Date: 06/27/2012]